



CITY OF
SCOTTSDALE, ARIZONA

Annual Financial Trends Report

October 2006

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INTRODUCTION

Purpose

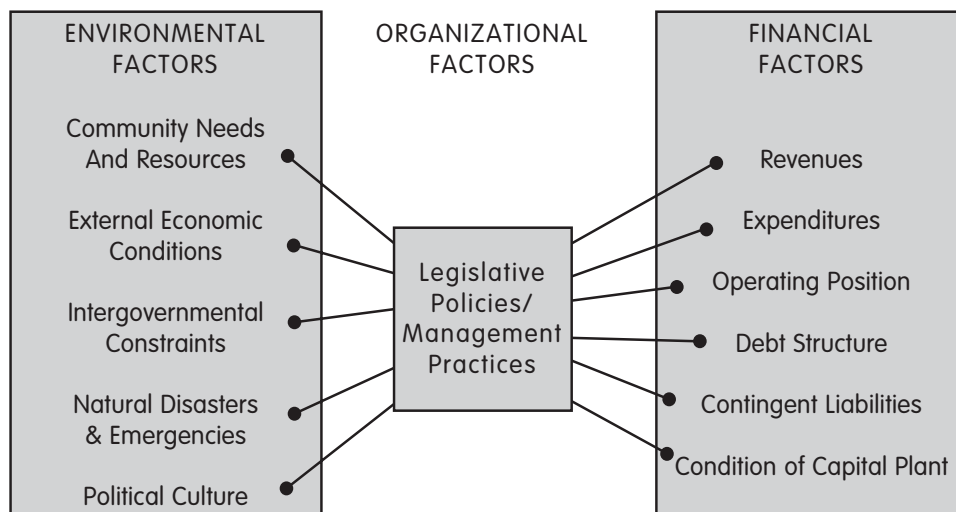
This financial trend analysis provides Scottsdale's citizens, elected officials, management, staff, and other stakeholders with information regarding existing and potential environmental, organizational, and financial problems that may impact the City's future fiscal health. As a useful management tool, it combines budgetary and financial information with economic and demographic data to create a series of local government indicators that can be used to monitor changes in the City's financial condition.

The analysis does not provide solutions to negative trends, nor does it provide a single number or index to measure the City's financial condition. When all of the financial indicators are considered together, interested stakeholders can gain a better understanding of the City's overall financial condition, i.e., similar to a credit rating agency analysis. Using this trend analysis and the framework of the financial policies adopted by City Council will enable management to strategically plan and budget, provide solutions to negative trends, and ultimately preserve the financial health of Scottsdale.

Organization

The analysis, as designed by the International City/County Management Association (ICMA), encompasses three primary factors that affect the City's financial condition: environmental factors, organizational factors, and financial factors. These factors are divided into twelve categories that influence financial conditions. As the chart below illustrates, the factors are arranged as inputs and outputs to each other representing cause-and-effect relationships. The factors are interrelated and, taken collectively, represent an inventory of considerations when evaluating financial conditions.

FINANCIAL CONDITION FACTORS



For this reason, the trend information, whether positive, negative or neutral, should be viewed collectively. A specific trend, if analyzed on its own, may provide a misleading representation of the City's financial condition. For example, the City's revenue per capita trended downward between fiscal year 2002 and 2003. However, expenditures per capita and the community's ability to pay for services also need to be considered to determine an overall trend of the City's cost of operations exceeding future revenue streams.

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The financial factors are separated into specific trend indicators. Scottsdale's financial policies, community needs and resources, overview of external economic conditions, and intergovernmental constraints are incorporated into the analysis. Other environmental and organizational factors cannot be quantified and, therefore, are not part of this analysis.

Executive Summary

The 2006 fiscal year saw the national and state economies continue to expand, although there was noticeable slowdown in several key sectors of the economy. Retail sales and tourism continued to see solid growth over 2005, backed by strong consumer spending and a steady job market. The construction and housing industries, however, saw a significant drop-off from the record-breaking performances of the past few years. Slowing worker productivity and higher inflation were also growing concerns as the fiscal year progressed. The national economy had been growing at a steady 3 to 5 percent rate since 2003. However, the national leading economic index trended downward in the second half of the fiscal year, further indicating a slowing economy that is expected to extend into 2007. Since economic performance tends to be cyclical in nature, there are short-term and long-term economic uncertainties that could have an impact on the strength and longevity of the current economic cycle as we head into 2007. These uncertainties include housing and construction markets, energy prices, inflation, rising interest rates, consumer confidence, job market, and geopolitical activity.

The City of Scottsdale's tax revenue base consists of a variety of tax categories, the most significant being revenue collections from retail sales, tourism, and construction activities. The City also benefits from other favorable conditions associated with Scottsdale, including a stable, diversified economic base and a desirable location for work, destination, and living. Low commercial vacancy rates and the attractive developments within Scottsdale continue to bring high-end residential growth and commercial development. Revitalization efforts have resulted in a rebirth of the City's downtown area, as well as renewed interest in redevelopment of the more mature, southern parts of the City. Commercial successes are due, in part, to Scottsdale's commitment to targeted recruitment efforts that focus on industry segments that complement the existing business mix, including: corporate headquarter and regional offices; high-tech, research and development; bio-med; high-end resorts and hotels, and business and professional services.

Based on fiscal year 2006, guarded optimism best describes Scottsdale's current economic outlook. The City saw solid revenue growth for the second consecutive year from essential components such as retail sales, tourism, and development activities. However, some of the revenue increases were predominantly reflective of Scottsdale's strong construction market and high building permit activity. These variances should be considered as one-time gains and not as recurring revenue sources to fund on-going operating expenses or debt service.

Current economic conditions allow the City to maintain core services and, in some cases, to provide enhancements to existing service levels. However, prudent long-term fiscal planning dictates a conservative financial approach, focusing on the highest Council and citizen priorities, and funding only those enhancements financially sustainable. The revenue forecasts used in the budget are cautiously optimistic. There is no assumption that the City has returned to the extraordinary economic conditions of the 1990s. The City is past its historic period of peak expansion and the long-term budget plans must recognize that fact.

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In order for Scottsdale to retain a high quality of place, the City will have to address many critical issues on its horizon. These issues include redevelopment and in-fill projects as the City reaches build-out, a shifting of the City's economic base as ample tax revenues from new growth will no longer exist, a gradual slowing in the City's population growth resulting in lower state-shared revenues, and intense competition from other communities in the region. The ongoing challenge for Scottsdale will be its ability to manage limited financial resources while addressing increasing operational and capital costs associated with growing demands for quality public services and an aging infrastructure in parts of the City. The Financial Services staff will continue to closely monitor the City's financial trends. If action is required to address unfavorable trends, staff will alert the City Manager and the City Council in a timely manner and bring forward strategic options for their consideration.

The following is a summary of the financial factor categories and the general five-year trend for each respective indicator.

Community Needs and Resources – These indicators reflect the community's ability to pay for services, as well as factors that impact the City's financial condition. The indicators reflect an overall steady performance for Scottsdale over the five-year span, especially in light of the economic recession that occurred during the early part of this timeframe. The City's growing population and employment base, increasing property values, and constant personal income levels all contributed to the City's financial condition and the community's ability to pay for services. As the economy began its recovery and tourism and retail sales increased, hotel/motel occupancy rates and business activity improved over earlier declining trends.

<i>Indicator</i>	<i>Five-Year Trend</i>
Population	Positive
Population Density	Positive
Inflation	Negative
Residential Development	Neutral
Hotel/Motel Occupancy Rates	Positive
Employment Base	Positive
Business Activity	Positive
Median Age	Neutral
Personal Income	Neutral
Property Value	Positive
Crime Rate	Positive

Revenues - Sales tax, property tax, intergovernmental revenues, and user-fee revenue trends were mixed over the five-year trend period.

<i>Indicator</i>	<i>Five-Year Trend</i>
Revenue Per Capita	Neutral
Elastic Revenue	Neutral
Property Taxes	Positive
Uncollected Property Tax	Neutral
Intergovernmental Revenues	Neutral
User Charge Coverage	Neutral
Restricted Revenue	Neutral

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Expenditures – The expenditure indicators show expenditure levels remaining proportional to the City’s population. Increases in total operating expenditures reflect increased demands for public services due to a growing population and additional maintenance requirements pertaining to both new and current facilities. Escalating health care, social security, and pension costs negatively impacted fringe benefit expenditures.

<i>Indicator</i>	<i>Five-Year Trend</i>
Expenditures Per Capita	Neutral
Operating Expenditures – Service Area	Neutral
Employees Per Capita	Neutral
Fringe Benefits	Negative

Operating Position - The operating position indicators reflect an overall solid financial base. The increase to fiscal years 2004-2006 General Fund ending balances were due to actual revenues higher than forecasted against conservative fiscal year budgets, and better-than-expected year-end department savings. Enterprise Funds also show positive earnings. A large portion of these fund balances are set-aside for emergencies and enterprise infrastructure and replacement. The City’s liquidity remains strong.

<i>Indicator</i>	<i>Five-Year Trend</i>
General Fund Balance	Positive
Enterprise Fund Earnings	Neutral
Liquidity	Neutral

Debt Structure - Net direct debt per capita increases are due to voter-approved bonds issued to pay for the five-year Capital Improvement Program. However, the City’s increasing assessed valuation and tax base mitigates the increasing debt.

<i>Indicator</i>	<i>Five-Year Trend</i>
Net Direct Debt Per Assessed Valuation	Neutral
Net Direct Debt Per Capita	Negative
Overlapping Net Debt	Positive
Debt Service	Neutral
Debt Margin – 20 percent Bonds	Neutral
Debt Margin – 6 percent Bonds	Neutral

Contingent Liabilities - The City’s employee pension benefit obligations, although increasing, are nearly fully funded. The funded pension status, unrestricted fund balances, and self-insurance reserve are strong safeguards for the City’s financial condition.

<i>Indicator</i>	<i>Five-Year Trend</i>
Pension Benefit Obligation	Negative
Compensated Absences	Neutral
Self-Insurance	Positive

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Condition of Capital Plant - The condition of capital plant indicators reflect prudent methodologies for maintenance and replacement of the City's capital assets. The neutral trends demonstrate that the City is maintaining capital investments rather than deferring maintenance costs for short-term benefits.

<i>Indicator</i>	<i>Five-Year Trend</i>
Maintenance Effort	Neutral
Capital Outlay	Neutral
Depreciation	Neutral

Sources

This financial trend analysis is based on publications of the International City Management Association (ICMA) on the evaluation of local government financial condition. The analysis draws on the expertise of governmental finance researchers, credit rating agencies, and the City's Financial Services staff. Trend indicators are based primarily on the City's economic base along with other external factors promulgated by such organizations as the Government Finance Research Center (GFRC), the National Advisory Council on State and Local Budgeting (NACSLB), the International City/County Management Association (ICMA), the Government Finance Officers Association (GFOA), Moody's Investors Service, Fitch Ratings, and Standard and Poor's Corporation.

The analytical techniques that are part of this evaluation system are similar to the analytical approaches used by the municipal credit rating industry. For example, certain indicators are adjusted for inflation, as measured by the Consumer Price Index (CPI), to yield constant dollars, thus representing the real growth or decline of the indicators. This technique can help the City analyze and interpret key financial, economic, and demographic trends and can provide management with information needed to improve the City's overall financial position and aid in the decision-making process. In order to ensure validity and consistency of the indicators, most data are tied to data published in the City's Comprehensive Annual Financial Report (CAFR). In addition, many indicators relate directly to information required by municipal credit rating agencies. The rating agencies, bond buyers, and other interested parties consider the annually audited and published CAFR as the most reliable financial information source for the City. The City presents its CAFR in accordance with Generally Accepted Accounting Principles (GAAP) and in a consistent format as promulgated by the GFOA.

FINANCIAL POLICIES

City of Scottsdale's Comprehensive Financial Policies

The following City financial policies adopted by Resolution by the City Council establish the framework for Scottsdale's overall fiscal planning and management. They set forth guidelines against which current budgetary performance can be measured and proposals for future programs can be evaluated. Scottsdale's publicly adopted financial policies show the credit rating industry and prospective investors (bond buyers) the City's commitment to sound financial management and fiscal integrity. The financial policies also improve the City's fiscal stability by helping City officials plan fiscal strategy with a consistent approach. Adherence to adopted financial policies promotes sound financial management, which can lead to improvement in City bond ratings and lower cost of capital.

Operating Management Policies

1. All departments will participate in the responsibility of meeting policy goals and ensuring long-term financial health. Future service plans and program initiatives will be developed to reflect current policy directives, projected resources and future service requirements. In order to ensure compliance with policy, sunset provisions will be required on all grant program initiatives and incorporated into other service plans, as appropriate.
2. The budget process is intended to weigh all competing requests for City resources, within expected fiscal constraints. Requests for new, ongoing programs made outside the budget process will be discouraged.
3. Budget development will use strategic multi-year fiscal planning, conservative revenue forecasts, and modified zero-base expenditure analysis that requires every program to be justified annually in terms of meeting intended objectives ("effectiveness criteria") and in terms of value received for dollars allocated ("efficiency criteria"). The process will include a diligent review of programs by staff, management, citizens and City Council.
4. A City Council Budget Sub Committee will solicit citizen input and serve in an advisory capacity in reviewing operating and capital budget recommendations from a departmental, program, and goals perspective.
5. Revenues will not be dedicated for specific purposes, unless required by law or generally accepted accounting practices (GAAP). All non-restricted revenues will be deposited in the General Fund and appropriated by the budget process.
6. Current revenues will fund current expenditures and a diversified and stable revenue system will be developed to protect programs from short-term fluctuations in any single revenue source. To ensure that Scottsdale does not become overly reliant on 'growth' revenues for operating needs, a minimum of 25% construction privilege tax revenues will be transferred annually to the Capital Improvement Program for one-time capital project use.
7. Addition of personnel will only be requested to meet program initiatives and policy directives, after service needs have been thoroughly examined and it is substantiated that additional staffing will result in increased revenue or enhanced operating efficiencies. To the extent feasible, personnel cost reductions will be achieved through attrition.

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8. Enterprise (Water, Sewer, Solid Waste Management, and Airport) user fees and charges will be examined annually to ensure that they recover all direct and indirect costs of service and be approved by the City Council. Any unfavorable balances in cost recovery will be highlighted in budget documents. Rate adjustments for enterprise operations will be based on five-year financial plans.
9. All non-enterprise user fees and charges will be examined annually to determine the direct and indirect cost of service recovery rate. The acceptable recovery rate and any associated changes to user fees and charges will be approved by the City Council.
10. Development impact fees, as permitted by state law, for capital expenses attributable to new development will be reviewed annually to ensure that fees recover all direct and indirect development-related expenses and be approved by City Council. Any unfavorable balances in cost recovery will be highlighted in budget documents.
11. Capital equipment replacement will be accomplished through the use of a “rental” rate structure. The rates will be revised annually to ensure that charges to operating departments are sufficient for operation and replacement of vehicles and other capital equipment (fleet, computers, phones and copier systems). Replacement costs will be based upon equipment lifecycle financial analysis.
12. Grant funding will be considered to leverage City funds. Inconsistent and/or fluctuating grants should not be used to fund ongoing programs. Programs financed with grant monies will be budgeted in separate cost centers, and the service program will be adjusted to reflect the level of available funding. In the event of reduced grant funding, City resources will be substituted only after all program priorities and alternatives are considered during the budget process.
13. Balanced revenue and expenditure forecasts will be prepared to examine the City’s ability to absorb operating costs due to changes in the economy, service demands, and capital improvements. The forecast will be updated annually, focus on a three-year horizon, but include a five-year outlook.
14. Alternative means of service delivery will be evaluated to ensure that quality services are provided to our citizens at the most competitive and economical cost. Departments, in cooperation with the City Manager, will identify all activities that could be provided by another source and review options/alternatives to current service delivery. The review of service delivery alternatives and the need for the service will be performed annually or on an “opportunity” basis.
15. Cash and Investment programs will be maintained in accordance with the City Charter and the adopted investment policy and will ensure that proper controls and safeguards are maintained. City funds will be managed in a prudent and diligent manner with an emphasis on safety of principal, liquidity, and financial return on principal, in that order.
16. The City will follow an aggressive, consistent, but sensitive to the circumstances policy of collecting revenues to the limit of our ability. Collection policy goal will be for all adjusted uncollectible accounts to be no more than .5 of 1% of the total City revenue being adjusted for bad debts annually.

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Capital Management Policies

17. A five-year Capital Improvement Plan will be developed and updated annually, including anticipated funding sources. Capital improvement projects are defined as infrastructure or equipment purchases or construction which results in a capitalized asset costing more than \$25,000 and having a useful (depreciable life) of two years or more.
18. The capital improvement plan will include, in addition to current operating maintenance expenditures, adequate funding to support repair and replacement of deteriorating infrastructure and avoidance of a significant unfunded liability.
19. Proposed capital projects will be reviewed and prioritized by a cross-departmental team regarding accurate costing (design, capital, and operating) and overall consistency with the City's goals and objectives. Financing sources will then be identified for the highest ranking projects.
20. Capital improvement lifecycle costs will be coordinated with the development of the Operating Budget. Future operating, maintenance and replacement costs associated with new capital improvements will be forecast, matched to available revenue sources and included in the Operating Budget. Capital project contract awards will include a fiscal impact statement disclosing the expected operating impact of the project and when such cost is expected to occur.
21. Dedicated two tenths of percent (.2%) privilege tax revenue for transportation improvements will be restricted to funding the planning, design, construction and acquisition costs associated with building, renovating, or enhancing capital projects for streets, highways, traffic control, transit and aviation and transportation improvement operating costs.
22. Pay-as-you-go Capital Improvement Plan financing should account for a minimum of 25 percent of all capital improvement projects for each five-year planning period. Pay-as-you-go financing is defined as all sources of revenue other than City debt issuance, i.e., fund balance contributions, developer contributions, grants, endowments, etc.
23. Pay-as-you-go contributions up to 10% or \$500,000, whichever is less, may be authorized by City Council towards any single utility undergrounding improvement district. Any unused annual budget authorization may carryforward towards a maximum \$2 million appropriation for utility undergrounding capital projects that benefit the community as a whole.

Debt Management Policies

24. The City will seek to maintain and, if possible, improve our current bond rating in order to minimize borrowing costs and preserve access to credit.
25. An analysis showing how the new issue combined with current debt impacts the City's debt capacity and conformance with City debt policies will accompany every future bond issue proposal.
26. The City will communicate, and, where appropriate, coordinate with all jurisdictions with which we share a common tax base concerning our collective plans for future debt issues.

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27. City Debt Service costs (GO, MPC, HURF, Revenue Bond, McDowell Sonoran Preservation and Contractual Debt) should not exceed 25% of the City's operating revenue in order to control fixed costs and ensure expenditure flexibility. Improvement District (ID) and Community Facility District (CFD) debt service is not included in this calculation because it is paid by district property owners and is not an obligation of the general citizenry. Separate criteria have been established regarding ID and CFD debt policies.
28. General Obligation debt, which is supported by property tax revenues and grows in proportion to the City's assessed valuation and/or property tax rate increases, will be utilized as authorized by voters. Other types of voter-approved debt (e.g., water, sewer, and HURF) may also be utilized when they are supported by dedicated revenue sources (e.g., fees and user charges).
29. General Obligation debt issuances will be managed on an annual basis to match funds to Capital Improvement Plan cashflow requirements while being sensitive to the property tax burden on citizens. Careful management of bond issuances will allow the City to not exceed \$1.50 property tax per \$100 assessed value.
30. Municipal Property Corporation and contractual debt, which is non-voter approved, will be utilized only when a dedicated revenue source (e.g., golf course revenue, privilege tax, bed tax) can be identified to pay debt service expenses. The following considerations will be made to the question of pledging of project (facility) revenues towards debt service requirements:
 - a. The project requires monies not available from other sources.
 - b. Matching fund monies are available which may be lost if not applied for in a timely manner.
 - c. Catastrophic conditions.
 - d. The project to be financed will generate net positive revenues (i.e., the additional tax revenues generated by the project will be greater than the debt service requirements). The net revenues should not simply be positive over the life of the bonds, but must be positive each year within a reasonably short period (e.g., by the third year of debt service payments).
31. McDowell Sonoran Preservation debt service will be funded by the dedicated .35% privilege tax. The City's privilege tax to revenue bond debt service goal will be at least 1.5:1 for senior lien debt to ensure the City's ability to pay for preserve debt from this elastic revenue source.
32. Improvement District (ID) and Community Facility District *(CFD) Bonds shall be permitted only when there is a general City benefit. ID and CFD bonds will be utilized only when it is expected that they will be issued for their full term. It is intended that ID and CFD bonds will be primarily issued for existing neighborhoods desiring improvements to their property such as roads, water lines, sewer lines, streetlights, and drainage.
 - a. Improvement District debt will be permitted only when the full cash value of the property, as reported by the Assessor's Office, to debt ratio (prior to improvements being installed) is a minimum of 3/1 prior to issuance of debt and 5/1 or higher after construction of improvements. Should the full cash value to debt ratio not meet the minimum requirements, property value may be determined by an appraisal paid for by the applicant and administered by the City. In addition, the City's cumulative improvement district debt will not exceed 5

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percent of the City's secondary assessed valuation. Bonds issued to finance improvement district projects will not have maturities longer than ten years.

- b. Community Facility District debt will be permitted only when the full cash value of the property, as reported by the Assessor's Office, to debt ratio (prior to improvements being installed) is a minimum of 3/1 prior to issuance of debt and 5/1 or higher after construction of improvements. In addition, the City's cumulative facility district debt will not exceed 5 percent of the City's secondary assessed valuation. The landowner/developer shall also contribute \$.25 in public infrastructure improvement costs of each dollar of public infrastructure improvement debt to be financed by the district.
- 33. Debt financing should not exceed the useful life of the infrastructure improvement with the average (weighted) bond maturities at or below ten years.
- 34. A ratio of current assets to current liabilities of at least 2/1 will be maintained to ensure the City's ability to pay short-term obligations.
- 35. Bond interest earnings will be limited to funding changes to the bond financed Capital Improvement Plan, as approved by City Council, or be applied to debt service payment on the bonds issued for construction of this plan.
- 36. Utility rates will be set, as a minimum, to ensure the ratio of revenue to debt service meets our bond indenture requirement of 1.2/1. The City goal will be to maintain a minimum ratio of utility revenue to debt service of 1.6/1 or greater, to ensure debt coverage in times of revenue fluctuations attributable to weather or other causes, and to ensure a balanced pay-as-you-go Capital Improvement Plan.

Reserve Policies

- 37. All fund designations and reserves will be evaluated annually for long-term adequacy and use requirements in conjunction with development of the City's balanced five year financial plan.
- 38. General Fund Stabilization Reserve of 10 percent of annual general governmental (General and Transportation funds) operating expenditures will be maintained for unforeseen emergencies or catastrophic impacts to the City. Funds in excess of 10 percent, but not to exceed \$5 million, may be used for economic investment in the community when justified by the financial return to the City.
- 39. Debt Service Reserve will be funded with secondary property taxes, levied by City Council, sufficient to pay the bonded indebtedness for General Obligation bond principal and interest. A debt service sinking fund will be maintained to account for these restricted revenues and debt payments, as well as any additional debt amounts deemed to be advisable and necessary for any public or municipal purposes. An excise tax debt reserve will be funded at no less than the annual debt service for all currently outstanding (1%) excise tax supported debt.
- 40. Water and Sewer Fund Reserves will be maintained to meet three objectives: (1) ensure adequate funding for operations; (2) to ensure infrastructure repair and replacement; and, (3) to provide working capital to provide level rate change for customers.

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- a. An Operating Reserve will be funded not to exceed 90 days of budgeted system operating expenditures to provide sufficient expenditure flexibility during times of unusual weather resulting in variations in average consumption and associated operating expenses.
 - b. A Replacement and Extension Reserve will be maintained, per bond indenture requirements, to meet the minimum requirement of 2% of all tangible assets of the system to ensure replacement of water and sewer infrastructure.
 - c. In addition, Working Capital will be funded based upon a multi-year financial plan to provide adequate cash for water and sewer capital improvements and to level the impact of rate increases upon our customers.
41. Solid Waste Management Fund Reserve will be funded not to exceed 90 days of budgeted system operating expenditures to provide contingency funding for costs associated with solid waste disposal. Costs may include site purchase, technology applications, or inter-governmental investment to maximize the value of waste disposal activities.
42. Aviation Fund Reserve will be funded not to exceed 90 days of budgeted system operating expenditures to provide contingency funding for costs associated with airport operations. Costs may include site purchase, technology applications, or inter-governmental investment to maximize the value of airport activities.
43. Self-Insurance Reserves will be maintained at a level, which, together with purchased insurance policies, will adequately indemnify the City's property, liability, and health benefit risk. A qualified actuarial firm shall be retained on an annual basis in order to recommend appropriate funding levels, which will be approved by Council.
44. Fleet Management Reserve will be maintained based upon lifecycle replacement plans to ensure adequate fund balance required for systematic replacement of fleet vehicles and operational contingencies. Operating departments will be charged for fleet operating costs per vehicle class and replacement costs spread over the useful life of the vehicles.
45. Contingency Reserves to be determined annually will be maintained to offset unanticipated revenue shortfalls and/or unexpected expenditure increases. Contingency reserves may also be used for unanticipated and/or inadequately budgeted events threatening the public health or safety. Use of contingency funds should be utilized only after all budget sources have been examined for available funds, and subject to City Council approval.

Financial Reporting Policies

46. The City's accounting and financial reporting systems will be maintained in conformance with all state and federal laws, generally accepted accounting principles (GAAP) and standards of the Governmental Accounting Standards Board (GASB) and the Government Finance Officers Association (GFOA).
47. An annual audit will be performed by an independent public accounting firm, with an audit opinion to be included with the City's published Comprehensive Annual Financial Report (CAFR). The independent auditor will present CAFR and discuss audit findings concerning internal controls and operational efficiencies at a public meeting.

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48. The City's CAFR will be submitted to the GFOA Certification of Achievement for Excellence in Financial Reporting Program. The financial report should be in conformity with GAAP, demonstrate compliance with finance related legal and contractual provisions, disclose thoroughness and detail sufficiency, and minimize ambiguities and potentials for misleading inference.
49. The City's CAFR will also be submitted to Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) as a continuing commitment to disclose thoroughness to enable investors to make informed decisions.
50. The City's Budget will be submitted to the GFOA Distinguished Budget Presentation Program. The budget should satisfy criteria as a financial and programmatic policy document, as a comprehensive financial plan, as an operations guide for all organizational units and as a communications device for all significant budgetary issues, trends and resource choices.
51. Financial systems will maintain internal controls to monitor revenues, expenditures, and program performance on an ongoing basis.

EXTERNAL ECONOMIC CONDITIONS

External Economic Conditions

External economic conditions relate to the macro economy and the impact on the City. The most relevant and measurable conditions are local economic indicators. However, national and state economic trends also are important since they can indicate future impacts and changes to the local economy, such as changes in state-revenue sharing. The following is an overview of some external economic conditions.

Local Economic Conditions at the Close of 2006 Fiscal Year

Retail Sales

Scottsdale's largest revenue source is sales tax generated from a well-balanced variety of business categories including automotive, construction, food stores, hotels/motels, department stores, retail stores, restaurants, utilities, and rentals. The City saw a second consecutive year of double-digit growth in sales tax revenues in FY 2005/06 with an 11.1 percent increase over the prior year's 10.5 percent gain – both positive indicators that the local economy is expanding. Major sales tax categories responsible for the revenue swing included automotive up 9.2 percent, construction up 11.8 percent, hotels and motels up 14.4 percent, major department stores up 25.8 percent, and restaurants up 9.4 percent from the previous year. Factors contributing to retail sales growth included high consumer confidence, strong consumer spending, declining unemployment, job growth, and continuation of historically low interest rates.

Employment and Job Growth

Scottsdale is creating jobs faster than it is adding to its labor force and thus remains a net importer of labor. This creates employment opportunities for Scottsdale residents and creates a significant business component to the local tax base. Scottsdale's unemployment rate was lower than both state and metropolitan levels and was approximately 3.0 percent in 2005.

Scottsdale recruited nine new, targeted firms and secured one expansion resulting in over 1,275 new jobs in FY 2005/06 with an average annual salary of \$56,000. The City benefited from population growth as well as higher income levels due to the addition of higher wage jobs. Major new employers to announce moves to Scottsdale in FY 2005/06 included InNexus, Sankyo Pharmaceutical, Efunds, and Sanofi/Aventis. The City also benefited from the expansions of DHL International, Ltd.

Vacancy Rates

Scottsdale's citywide office vacancy rate was 13.5 percent at the end of FY 2005/06, well below the Valley-wide average. Scottsdale's weighted average rent was 10.1 percent higher than the Valley-wide average, evidence that Scottsdale remains an attractive city to conduct business.

Tourism

Tourism is one of Scottsdale's largest industries and is a significant contributor to the City's economy. Numerous resort and convention facilities, along with many hotels and motels, provide nearly 10,000 guest rooms, along with many public and private golf courses and tennis courts, and several country clubs. The number of rooms is expected to remain stable through 2006, with additional rooms coming into the market in 2007 and 2008. More than 17,000 retail shops, boutiques, and galleries are located throughout the City and a selection of almost 600 restaurants is available. These services and facilities, complemented by the mild winter, have made Scottsdale a popular vacation spot for tourists and winter visitors.

EXTERNAL ECONOMIC CONDITIONS

Hotel/motel transient occupancy tax receipts increased approximately 12.6 percent in FY 2005/06 over the previous year – the third straight year of revenue growth after post 9/11 levels. Room rates and room occupancy are nearing the levels experienced by the industry in the late 1990s and the early 2000s. The current assessment for tourism in FY 2006/07 is that these positive trends will continue, although factors such as high energy costs, inflationary pressures, a slowing housing market, and geopolitical instability in the Middle East could all impact future industry performance.

Economic Outlook for 2007 and Beyond

The future strength of Scottsdale's economy and financial condition will hinge on many factors from both a local and macro view. Continued growth of retail sales and tourism is essential to the City's financial wellbeing. As the City reaches build-out over the next 10 years, new development and population growth will slow and Scottsdale will face a shifting economic base. Ample tax revenues from development will no longer exist and the distribution of state-shared revenues will shift to faster growing communities, creating a heavier reliance on new and existing revenue streams to support operations and to fund demands for service from the community. Scottsdale will need to continue its renewed focus on redevelopment and revitalization of its downtown and original sections of the City in order to spur new business activity, additional sales tax revenues, and to offer high quality of place for its residence and visitors.

From a national perspective, the current economic forecast calls for stable, but slowing growth in the economy that should carry into the 2007 calendar year. The economy has been growing at a 3 to 5 percent rate since 2003, but there are signs of a slowing economy. Short-term concerns include slowing housing and construction activity, declining national economic indices, rising inflation and interest rates, fluctuating consumer confidence, and lower worker productivity. Long-term concerns for the economy include growing national debt and trade deficits, exporting of jobs overseas, demands on Social Security as baby-boomers near retirement, cost of health care, and geopolitical instability. All of these issues require prudent and fiscally conservative forecasting and budgeting practices to ensure that the City can adapt to sudden fluctuations in the national, state, and local economies.

INTERGOVERNMENTAL CONSTRAINTS

Intergovernmental Constraints

Unfortunately, the City's economic fate is not completely under its control. Scottsdale is constrained by the imposition of other governmental units. These impositions affect both the City's ability to collect revenue and necessitate expenditures for regulatory items that do not necessarily provide a direct service to Scottsdale residents. The following is an overview of key intergovernmental constraints affecting Scottsdale's operations.

Property Tax Limit

In 1980, Arizona voters approved two measures to contain local government spending in response to California's Proposition 13. By a Constitutional amendment the property tax was split into two distinct components, primary and secondary. The primary levy is limited as to amount that may be used for any purpose. The levy is limited to a two percent increase over the previous year's "maximum allowable levy", plus the addition of any new property not previously taxed. The secondary levy is unlimited as to amount, but can only be used to repay voter approved debt service. The City must notify the State by November 1st of the year before the tax is levied of any annexations in order for them to be included on the tax rolls. Any annexations after November 1st must wait until the following year to be included in the City's levy. In addition, cities have the right to levy property taxes to pay for the cost of involuntary tort judgments.

At the time of this report, there is a voters' initiative, Proposition 101 – known as the "2006 Taxpayer Protection Act" – that would amend the Arizona Constitution to remove unused taxing capacity and reset each taxing entity's limit to the actual tax levy of that county, city, town, or community college district in 2005. Beginning in 2007, the new levy limit would increase by 2.0 percent per year, plus any new construction.

Expenditure Limit

The expenditure limit, imposed by the State, is tied to the amount spent in the established "base year" (fiscal year 1979/80). Each year, the State adjusts the City's base year expenditure limit for changes in population and the implicit price deflator. Some items specifically excluded from the expenditure limitation are Federal grants, debt service payments, and involuntary tort judgments. Scottsdale voters have previously approved three adjustments to the expenditure limitation: a permanent exclusion for capital improvement expenditures approved in 1982, a \$12.5 million base adjustment approved in 2000, and a \$12 million adjustment approved in 2006. Penalties for exceeding the expenditure limit include the loss of State-shared revenues in the fiscal year following the violation.

State-Shared Revenues

Scottsdale receives a share of monies collected by the State since cities and towns in Arizona are not permitted to levy an income tax. Some money, such as State-Shared Sales Tax and State-Shared Income Tax, are unrestricted as to use. Other revenues, such as Highway User Fuel Tax and Local Transportation Assistance Funds, are restricted to transportation purposes only.

In addition to the restrictions on use of these funds, there are also differing methods of distribution that impact Scottsdale's revenue share. In some cases, United States Census figures are used to calculate revenue distribution. State revenues allocated based on city population are of particular concern to Scottsdale in the near-future since the City's population growth has slowed compared to other rapidly growing Phoenix metropolitan cities that stand to benefit the most. Other revenue distribution methods are based on the county in which the revenue originated.

INTERGOVERNMENTAL CONSTRAINTS

State-Shared Income Tax receipts are received by the City based on income earned two years prior to distribution. The State of Arizona income tax calculations are tied to the federal tax system and, therefore, fluctuations in federal income tax levels caused by economic downturns or tax cuts can negatively impact the State's income tax revenues. The distribution of the State Income Tax to Scottsdale is projected to increase in fiscal year 2007, as future receipts will be based on income earned during the economic rebound in fiscal year 2005. Also, because of greater than expected statewide revenues, state-shared sales tax receipts to the City are also projected to increase in fiscal year 2007.

Unfunded Mandates

Increasing demands for government services and regulatory mandates at the Federal and State levels may result in the City incurring unfunded mandates, i.e., programs that cities are required to provide with no identified source of funding. For example, the US Department of Justice (FBI) required all computer systems that connect to their network to AES encrypt and apply two-factor authentication to users that are connecting over a public circuit, including wireless. This unfunded requirement for the City had to be placed in operation by September 2005 to avoid possible sanctions.

Mandated environmental regulations continue to impact Scottsdale's budget as well. Many aspects of City business are affected by environmental mandates, particularly land acquisition, water, sewer, and refuse operations. Scottsdale is required to comply with Federal and State regulations regarding treating storm water runoff, testing for drinking water chemicals, and underground storage tank leaks. The City must also comply with State surface water quality standards, industrial pretreatment requirements, and non-hazardous liquid waste processes.

For example, Scottsdale's fiscal year 2007 budget includes a water rate increase reflecting the capital and associated operating impacts of arsenic and disinfection by-product unfunded regulations enacted by the United States Environmental Protection Agency (EPA). In addition to the rate increase, the City recently issued \$88.4 million in new debt to meet the needs of the water enterprise fund that have been significantly impacted by the capital costs required to meet federal health and environmental regulations.

Other examples of unfunded environmental mandates include the 1980 Groundwater Management Act, which requires the City to work toward eliminating the reliance on mined groundwater, and the National Pollution Discharge Elimination System (NPDES), which requires the City to meet strict storm water quality levels.

Restricted Revenues

Restricted revenue is legally earmarked for specific use as may be required by State law, bond covenants, or grant requirements. For example, the State of Arizona requires that gas tax revenue be used only for street maintenance or construction. As the percentage of restricted revenue increases, the City loses its flexibility to respond to changing conditions. The overdependence on restricted revenues makes the City's programs vulnerable to dictates by the funding agencies and may signal a future inability maintain current service levels, at a minimum.

Bonding and Bond Capacity

All General Obligation and Revenue bonds must be approved by a vote of the citizens. Additionally, the Arizona Constitution imposes limits on the principal amount of General Obligation bonds allowed to be outstanding at any point in time depending on the use of the bond proceeds. Subject to voter approval, bonds amounting to 20 percent of the assessed value of taxable property in the City can be issued for water,

INTERGOVERNMENTAL CONSTRAINTS

wastewater, artificial light, open space preserves, parks, playgrounds, and recreational facilities. The City is limited to 6 percent of the assessed value of taxable property for all other types of capital expenditures, such as transportation, public safety, and general governmental facilities. Bond capacity is the portion of the legal debt limit available for bonding.

Several different kinds of Revenue bonds are available to the City. Revenue bonds are not included in the 20 percent and 6 percent capacity calculation. These bonds generally carry a higher risk and, therefore, higher interest rates than General Obligation bonds that are supported by the full faith and credit of the City. Water & Sewer Revenue bonds are payable from the Water & Sewer System user charges. Highway User Revenue Fund bonds are payable from Highway User revenues. Both Water & Sewer Revenue bonds and Highway User Fund Revenue bonds require voter approval.

Reporting Requirements

State law requires that the City establish at least two funds – the General Fund for recording “general” City operations and the Highway User Reserve Fund (HURF), which records the monies from highway user revenues. In addition to these requirements, additional funds are established to respond to reporting requirements for Federal grants, bond rating agencies, and regulatory accounting agencies. For example, the City’s Grant fund is used to account for federal, state, and local grant revenues received and expended by the City according to the stated purpose in each approved grant agreement. Also, the City’s Debt Service fund is used to account for secondary property taxes and other revenues restricted for repayment of City debt obligations.

COMMUNITY NEEDS AND RESOURCES

Community Needs and Resources

Community Needs and Resources encompass various economic and demographic characteristics including population, employment, personal income, property value, and business activity. These indicators describe and quantify a community's wealth and economic condition. They provide insight into the community's collective ability to generate revenue relative to the community's demand for public services such as public safety, capital improvements, and social services.

Community needs and resources are all closely interrelated and affect each other in a continuous cycle of cause and effect. In addition, changes in these characteristics tend to be cumulative. These characteristics are the most difficult to formulate into indicators because the data is not easy to gather. The indicators detailed in this section represent only those for which data is reasonably available.

In addition to analyzing these indicators, the City may also want to study more subjective issues, such as economic geography, location advantages, and land-use characteristics, as they all relate to the City's ability to generate revenue and, therefore, provide convenient, efficient public services. Also important are the City's plans and potential for future development. The diversification of the commercial and industrial tax base should be considered for its revenue-generating ability, employment-generating ability, vulnerability to economic cycles, and relationships to the larger economic region. While difficult to quantify using indicators, this information is useful in evaluating the City's financial condition.

An examination of local economic and demographic characteristics can identify the following types of situations:

- A declining tax base and correspondingly, the community's ability to pay for public services.
- A need to shift public service priorities because of demographic changes in the community.
- A need to shift public policies because of a loss in competitive advantage of the City's businesses to surrounding communities or because of a surge in inflation or other changes in regional or national economic conditions.

COMMUNITY NEEDS AND RESOURCES

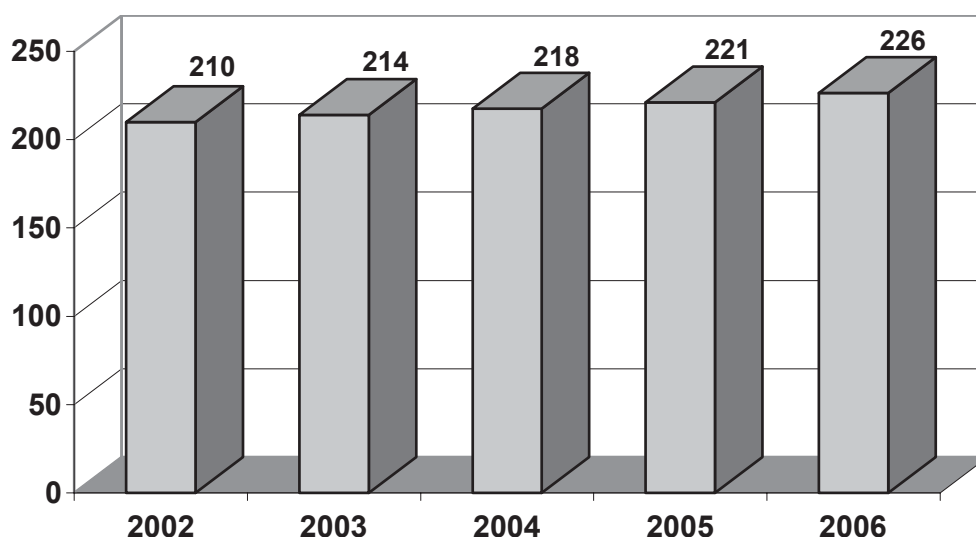
Population

Description

Changes in population can directly affect City revenues, such as property tax collections and distribution of state-shared revenues. Population level indirectly relates to such issues as employment, income, and property value.

Analysis

Scottsdale continued to experience steady, but moderate, population growth from fiscal years 2002 to 2006. The rate of growth has slowed in recent years with the decline of new residential development as the City reaches build-out. A gradually increasing population trend is considered favorable. Although population increases resulted in a higher demand for public services, the community's tax base and income levels remained strong over the same period. Looking ahead, the City's slowing population growth relative to other Phoenix-metropolitan cities will have an impact on intergovernmental revenues distributed to Scottsdale based on population levels.



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Population	210	214	218	221	226
Percent Change	3.6%	2.0%	1.6%	1.6%	2.4%

Source: City of Scottsdale CAFR

Calculation: (Current year less previous year)/Previous year (*100)

COMMUNITY NEEDS AND RESOURCES

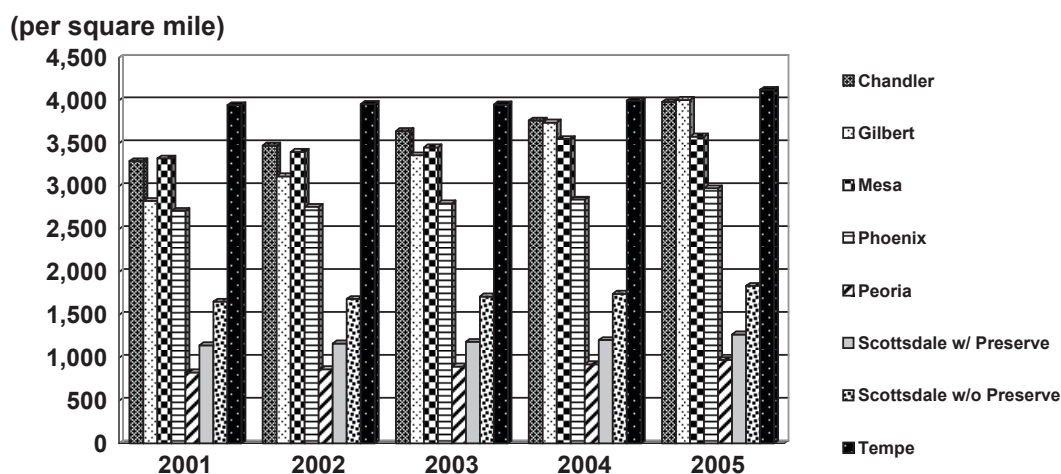
Population Density

Description

Population Density indicates the number of residents living in an occupied area (usually measured by square mile). Density readings can lend insight into the age of a city, growth patterns, zoning practices, new development opportunities, and the level of multi-family unit housing. High population density can also indicate whether a city may be reaching build-out, as well as service and infrastructure needs, such as additional public transit or street routes.

Analysis

The City of Scottsdale has one of the lowest population densities per square mile compared with other major Phoenix-metropolitan cities. This can be attributed to the City's strict zoning and open space requirements, especially in the northern part, as well as preservation efforts for undeveloped land, such as the McDowell Sonoran Preserve. To demonstrate the impact of the Preserve area on the City's overall population density, excluding the 56.875 square miles of Preserve area increases the City's population density by almost 45 percent – although still well below many other Phoenix-metropolitan cities.



(population density per square mile)	FYE 6/01	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05
Chandler	3,294	3,475	3,644	3,766	3,981
Gilbert	2,828	3,117	3,362	3,743	4,006
Mesa	3,325	3,401	3,454	3,550	3,580
Phoenix	2,713	2,760	2,800	2,846	2,976
Peoria	831	867	900	925	975
Scottsdale w/ Preserve	1,146	1,167	1,187	1,208	1,273
Scottsdale w/o Preserve	1,656	1,688	1,716	1,747	1,840
Tempe	3,946	3,958	3,953	3,999	4,125

Source: City of Scottsdale, Planning and Development Services Department

Calculation: Population/Area (SqMi)

COMMUNITY NEEDS AND RESOURCES

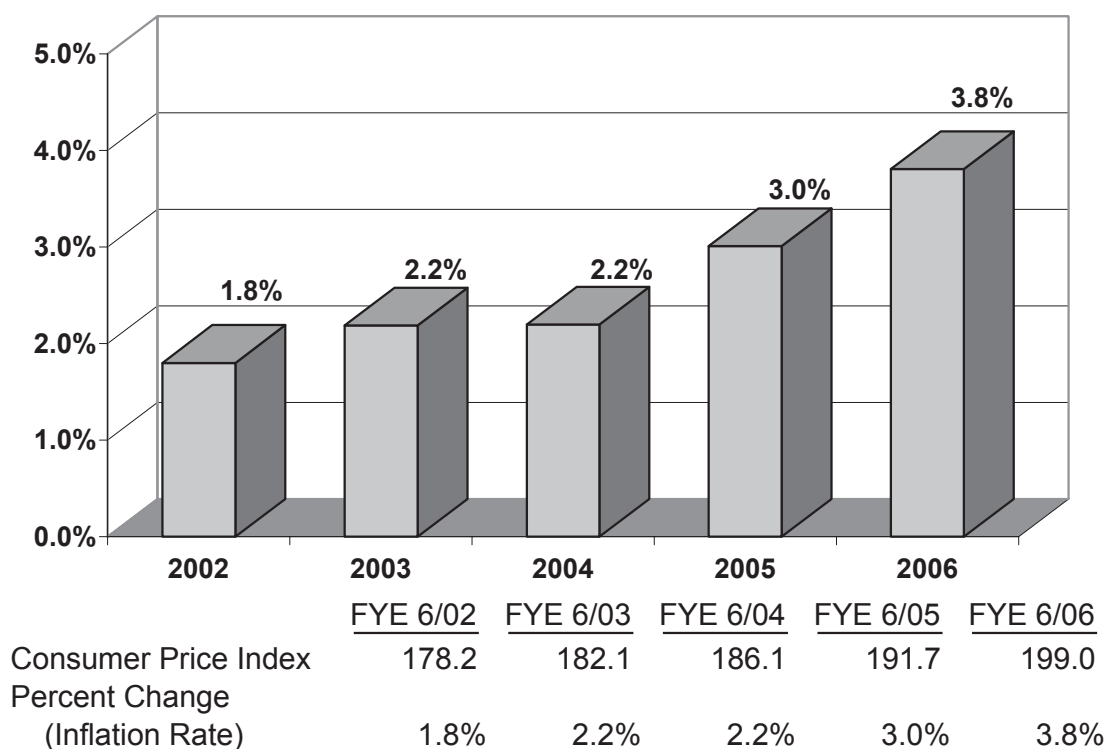
Inflation

Description

The Consumer Price Index (CPI) is one of the most widely recognized and used measures of the average change in prices paid by consumers for goods and services over a period of time. The CPI is based on a weighted-average of prices for a market basket of goods from eight different groups: food and beverages, housing, apparel, transportation, medical care, recreation, education and communication, and other goods and services (e.g., tobacco and smoking products, haircuts and other personal services). Stability in price level changes and continued low rates of inflation are generally beneficial and indicate a positive trend.

Analysis

The rate of inflation over the measured period has trended upward over the five-year period. After dropping to 1.8 percent in fiscal year 2002 due to the economic recession and weak labor markets, the inflation rate has grown to 3.8 percent in 2006. Rising inflationary pressures are mainly a result of continued economic growth, periodic increases to the borrowing rate by the Feds, and lower overall worker productivity nationwide.



Source: US Bureau of Labor Statistics

Calculation: $(\text{Current CPI} - \text{previous CPI}) / \text{Previous CPI} (*100)$

COMMUNITY NEEDS AND RESOURCES

Residential Development

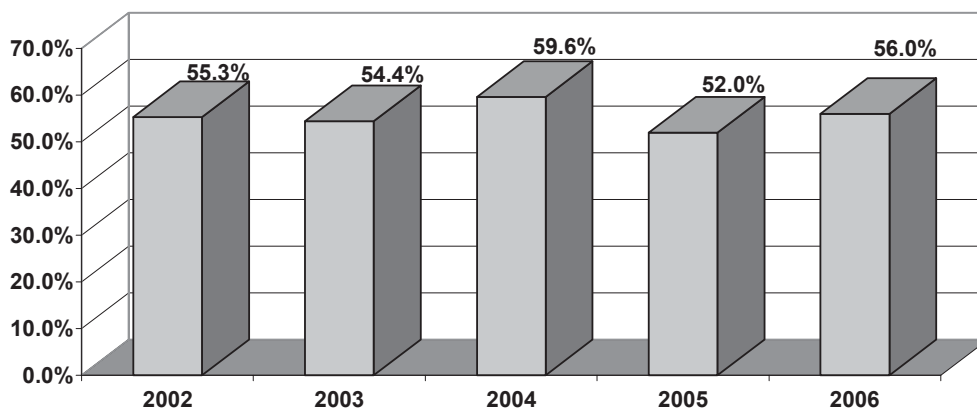
Description

Generally, the net cost of servicing residential development is higher than the net cost of servicing commercial or industrial development. Under this set of circumstances, the ideal condition would be to have sufficient commercial and industrial development to more than offset the costs of the residential development. There are exceptions to this situation. For example, a high-density residential area occupied by middle-aged, wealthy families whose children have already left home, who are heavy consumers, and who look to the government for very few services, can generate more revenues than service costs.

Analysis

The City's residential development as a percent of total property remained above 50 percent for fiscal year 2006 after seeing construction rebound in 2004 due to historically low interest rates. In the near-term, the market share of custom residential construction in Scottsdale should increase over new mass-market homes due to a shrinking inventory of subdivision parcels available for standard residential construction. Also, residential reinvestment should take on an increased share of residential development because of infill and redevelopment projects, especially in the City's southern areas.

(as % of total property)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Assessed Value					
Residential Property	\$1,813,072	\$1,918,472	\$2,369,729	\$2,460,307	\$2,917,414
Assessed Value					
All Property	\$3,277,951	\$3,526,605	\$3,975,522	\$4,735,691	\$5,209,444
Percent Residential					
Development/Total Property	55.3%	54.4%	59.6%	52.0%	56.0%

Sources: FYE 2002-2004 CAFR Table Xb Class 3 and Class 4 Secondary Net Assessed Value. FYE 2005-2006 City of Scottsdale, Financial Services Department.

Calculation: (Assessed Value Residential/Assessed Value All Property)*100

COMMUNITY NEEDS AND RESOURCES

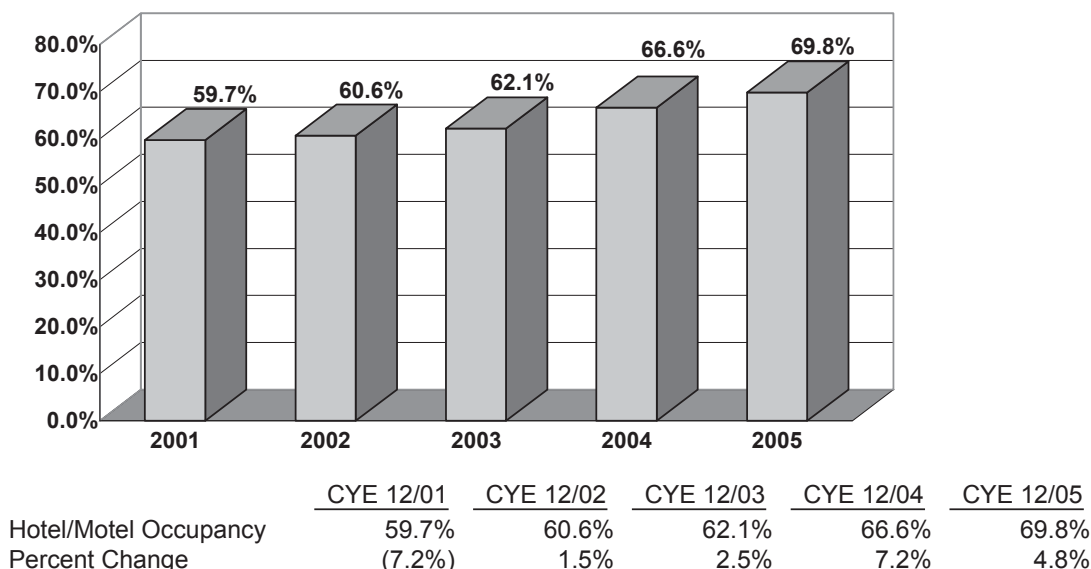
Hotel/Motel Occupancy Rates

Description

If the economy is sluggish or declining, the demand for hotel and motel rooms can go down and occupancy rates may decrease. Conversely, a growing economy may lead to higher demand for hotel and motel room rentals and, therefore, higher occupancy rates. This indicator can provide early warning of more serious economic problems.

Analysis

Similar to other tourist destinations, the recession and 9/11 terrorist attacks had negative impacts on both leisure and business travel to Scottsdale in calendar year 2001. In addition, increased competition from new hotels in neighboring cities has had an impact on demand for hotel rooms in Scottsdale. Since 2001, the tourism industry has seen a slow but steady increase in leisure and business travelers, which is reflected in Scottsdale's rising occupancy rates over the measured period.



Source: City of Scottsdale, Office of Economic Vitality (Smith Travel Research).

Calculation: (Current year less previous year)/Previous year (*100)

Note: Data is on a calendar year basis.

COMMUNITY NEEDS AND RESOURCES

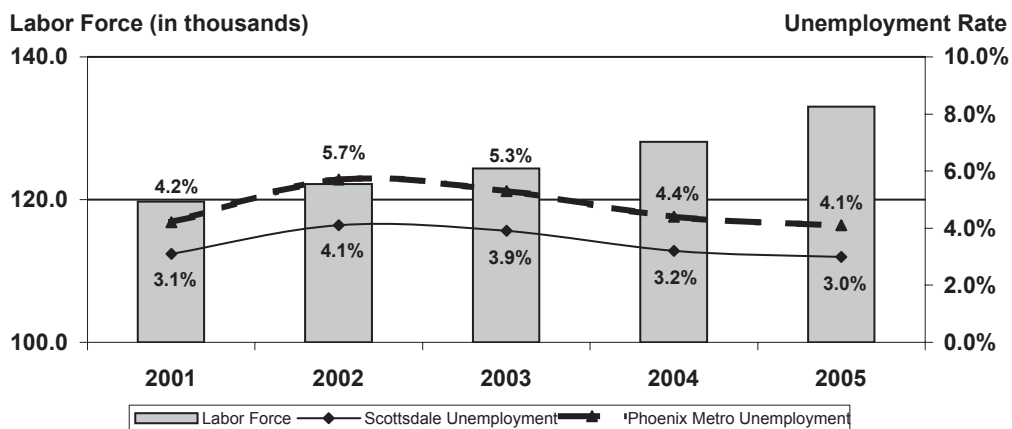
Employment Base

Description

Changes in the rate of employment of the community's citizens are related to changes in personal income and, accordingly, are a measure of and an influence on the community's ability to support its local business sector. A decline in employment base, as measured by lack of employment, can be an early warning signal that overall economic activity and governmental revenues may be declining.

Analysis

Scottsdale has experienced steady growth in the labor force from 2001-2005 – the unemployment rate rose during calendar years 2001 and 2002 due to national and local recessions. During the five-year period, however, Scottsdale's unemployment rates have remained lower than the surrounding cities' unemployment rates and are significantly lower than the State and national unemployment rates, results of a well educated and highly trained work force, and available employment from the City's business segment.



	CYE 12/01	CYE 12/02	CYE 12/03	CYE 12/04	CYE 12/05
Scottsdale Labor Force	119,700	122,200	124,400	128,100	133,000
Scottsdale Unemployment Rate	3.1%	4.1%	3.9%	3.2%	3.0%
Phoenix-Metro Unemployment Rate	4.2%	5.7%	5.3%	4.4%	4.1%

Source: Arizona Department of Economic Security, unemployment rates and labor force statistics (LAUS).

Note: Data is on calendar year basis.

COMMUNITY NEEDS AND RESOURCES

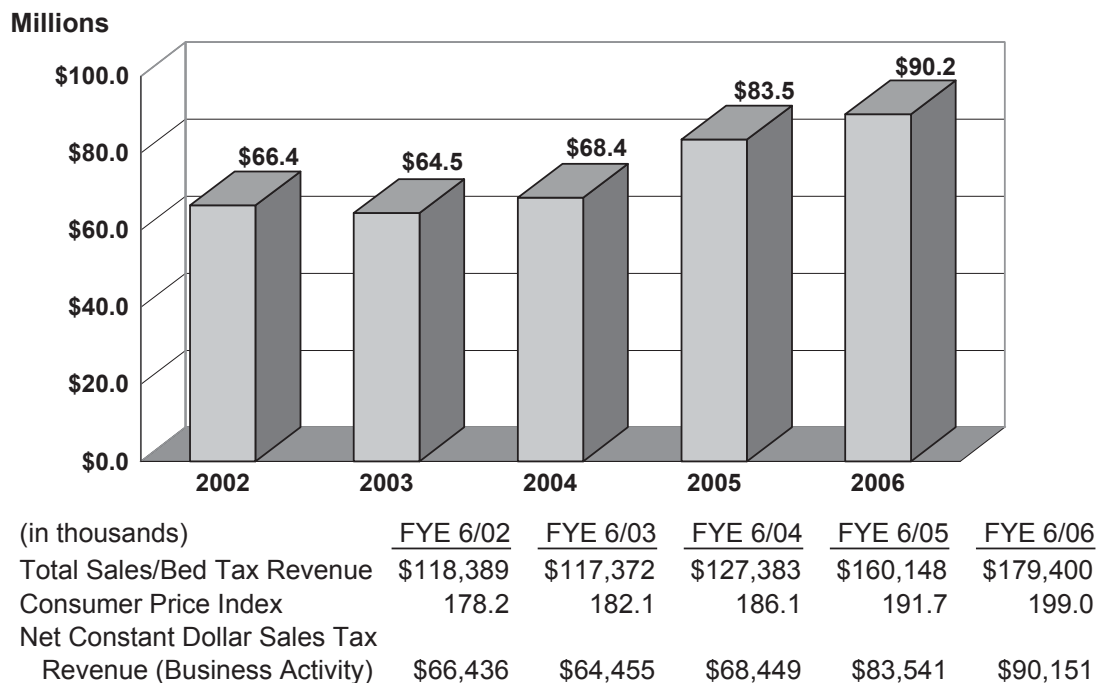
Business Activity

Description

The level of business activity directly affects the City's financial condition by revenue sources, such as sales tax and bed tax receipts, and indirectly to the extent that a change in business activity affects other demographic and economic areas, such as employment base, personal income, or property values. Changes in business activity also tend to be cumulative, causing a positive or negative impact on all related factors such as employment base, income, and property value.

Analysis

From 2002 to 2003, Scottsdale experienced a decline in overall sales tax collections due to the economic downturn after 9/11. Recent years show a rebound in sales tax and bed tax revenues and corresponding business activity for the City due to the economic recovery during this period. Higher consumer confidence and consumer spending, strong retail sales activity, the resurgence of tourism, and newly added business segments from companies locating to Scottsdale all contributed to the City's growth in sales tax revenues.



Sources: CAFR Statement of Revenues, Expenditures and Changes in Fund Balances for Governmental Funds. US Bureau of Labor Statistics for All Urban Consumers.

Calculation: Sales and Bed Tax/CPI (*100)

COMMUNITY NEEDS AND RESOURCES

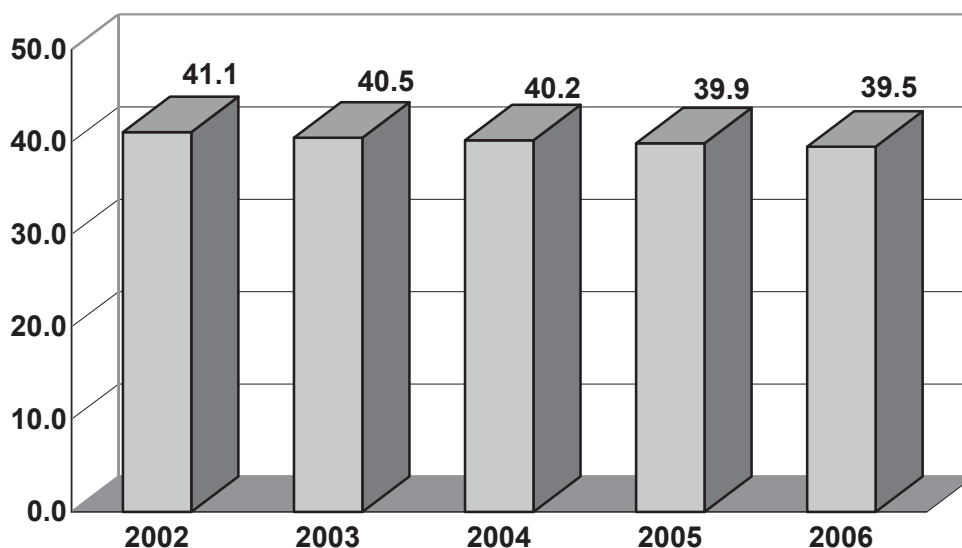
Median Age

Description

Median age of population may affect both City revenues and expenditures. Income of seniors in the form of social security and pension payments are not subject to tax and seniors tend to spend less than younger persons. Expenditures may be affected by seniors requiring higher public service costs, such as health and welfare, and families with young children demanding services for schools, recreational, and related programs. A younger median age for a city may pose different opportunities and challenges, such as the community's ability to reinvest in businesses, neighborhoods and homes, the availability of secondary and postsecondary education, and the number of bars and clubs in its entertainment districts.

Analysis

The median age of Scottsdale's population trended downward over the five-year period and is within the midrange portion of the working age. Scottsdale's downtown revitalization and the ASU/Scottsdale Center for New Technology and Innovation site are helping to develop an urban setting that appeals to younger, creative, and high-tech individuals.



	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Median Age	41.1	40.5	40.2	39.9	39.5
Percent Change	0.2%	-1.5%	-0.7%	-0.7%	-1.0%

Sources: FYE 2002-2004 CAFR Table XIX. FYE 2005-2006 CAFR Table XVI.

Calculation: (Current less previous year)/Previous year (*100)

COMMUNITY NEEDS AND RESOURCES

Personal Income Per Capita

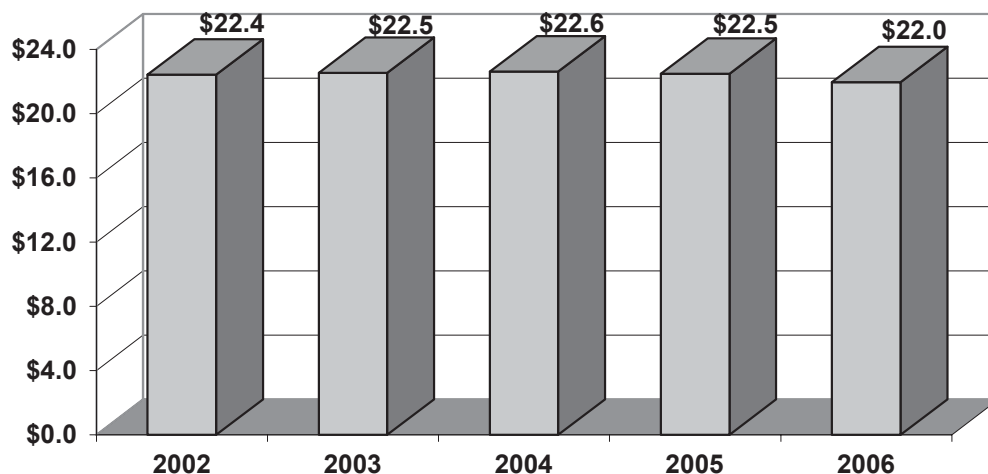
Description

Personal income is one measure of a community's ability to pay taxes. Generally, the higher the per capita income, the more property taxes, sales taxes, income taxes, and business taxes the City can generate. If income is distributed evenly, a higher per capita income will usually mean a lower dependency on governmental services, recreation, and welfare. A decline in per capita income results in loss of consumer purchasing power and can provide advance notice that businesses, especially in the retail sector, will suffer a decline that can ripple through the rest of the City's economy. Credit rating firms use per capita income as an important measure of a City's ability to meet its financial obligations.

Analysis

The City's per capita personal income remained strong during the five-year measurement period. The slight decline in 2006 can be attributed to inflationary factors from a rising CPI, which affects the value of the dollar. The overall consistent trend indicates that Scottsdale consumers have significant purchasing power and the ability to pay for public services.

Thousands (in constant dollars)



	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Personal Income (millions)	\$8,397	\$8,787	\$9,158	\$9,541	\$9,896
Consumer Price Index	178.2	182.1	186.1	191.7	199.0
Population (in thousands)	210	214	218	221	226
Net Constant Dollar					
Personal Income (in 000s)	\$22.4	\$22.5	\$22.6	\$22.5	\$22.0

Sources: CAFR Table XVI. US Bureau of Labor Statistics for All Urban Consumers.

Calculation: $(\text{Per Capita Income} * \text{Population}) / \text{CPI} / \text{Population} * 100$

COMMUNITY NEEDS AND RESOURCES

Property Value

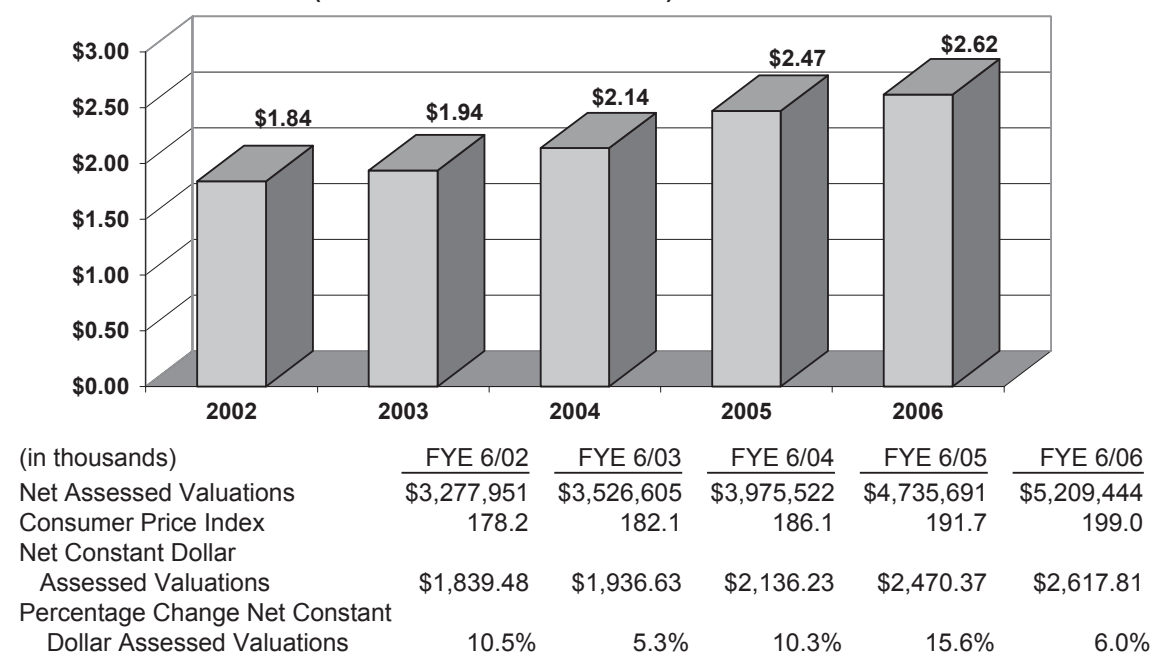
Description

Property value is an important indicator since general property taxes (primary tax) account for approximately 8 percent of City operating revenue. With Scottsdale maintaining a relatively stable tax rate, higher aggregate property values generate greater property tax revenue. The net assessed value is used as an indicator of the City's aggregate property value on which the property tax rate is applied to compute City property tax revenue.

Analysis

Scottsdale's assessed valuation has experienced solid, constant growth from fiscal year 2002 to 2006, which is a good indicator of the community's economic well-being and revenue base. This positive trend indicates that the community's tax base and its ability to pay for public services and capital projects are healthy.

Net Assessed Valuations (in billions of constant dollars)



Sources: FYE 2002-2004 CAFR Table IX. FYE 2005-2006 City of Scottsdale, Financial Services Department. All years - US Bureau of Labor Statistics for All Urban Consumers.

Calculation: Net Assessed Value/CPI

COMMUNITY NEEDS AND RESOURCES

Crime Rate

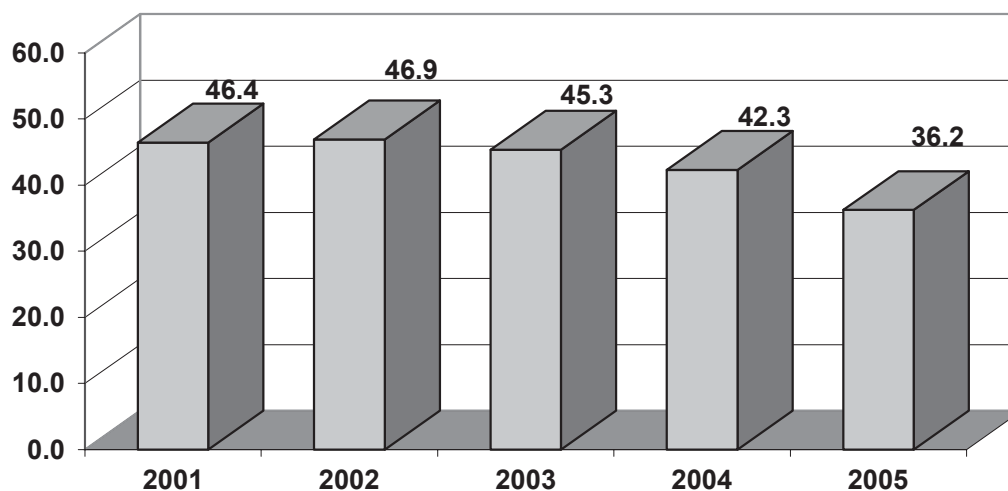
Description

A city's crime rate can significantly impact all aspects of a community's well-being. Rising crime rates may not only ruin a city's reputation, but may also result in additional direct and indirect financial burdens to the city, such as additional police enforcement, increased costs for repair or replacement of damaged or stolen property, higher rates for property and auto insurance, and declines in tourism and overall population. In general, a city with growing population tends to experience an increase in crime activity. The goal should be to keep criminal activity in check with minimal spikes to the crime rate in order to ensure the safety of its residence and visitors, and to maintain a high quality of place and destination.

Analysis

Despite the City's growing population, Scottsdale has seen a downward trend in Part I Offenses since 2002, indicating effective public safety efforts by the City. Part I Offenses are eight crime categories identified by the Federal Bureau of Investigation to measure criminal activity. The categories include theft, car theft, burglary, robbery, assault, homicide, rape, and arson.

(per 1,000 population)



(per 1,000 population)	CYE 6/01	CYE 6/02	CYE 6/03	CYE 6/04	CYE 6/05
Total Part I Crimes	9,912	10,187	10,013	9,498	8,228
Population	213,430	217,130	220,860	224,450	227,040
Crime Index per 1,000	46.4	46.9	45.3	42.3	36.2

Source: City of Scottsdale, Police Department - Uniform Crime Report

Calculation: Total Part I Crimes/Population (*1000)

Note: Data is on a calendar year basis.

REVENUE

Revenue

Revenue determines the capacity of the City to provide services. Important issues to consider with respect to revenue are economic growth, diversity, reliability, flexibility, and administration. Under ideal conditions, revenue should be growing at a rate equal to or greater than the combined effects of inflation and expenditures. Revenue should be sufficiently unrestricted to allow for necessary adjustments to changing economic and operational conditions. Revenue should be balanced between elastic and inelastic sources with respect to economic base and inflation. Some revenue sources should grow with the economic base and inflation, while others should remain relatively constant. Revenue should be diversified by source so as not to be overly dependent on residential, commercial, or industrial land uses, or external funding sources such as Federal grants or discretionary State aid. User fees should be regularly reevaluated to cover the full costs of services.

Analyzing the City's revenue structure will help to identify the following types of problems:

- Deterioration of revenue base.
- Internal procedures or legislative policies that may adversely affect revenue yields.
- Overdependence on obsolete or external revenue sources.
- Changes in tax burden.
- Lack of cost controls and poor revenue estimating practices.
- Inefficiency in the collection and administration of revenue.

The indicators detailed on the following pages can be used to monitor changes in revenue.

REVENUE

Revenue Per Capita

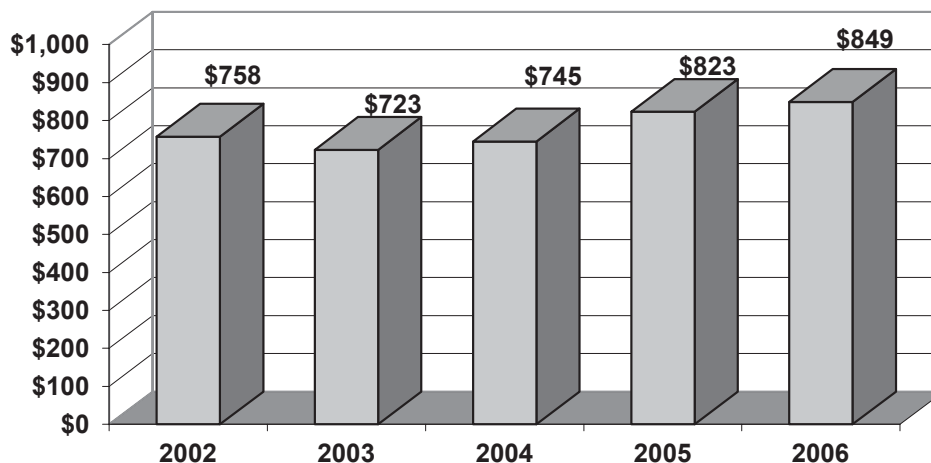
Description

Per capita revenue illustrates revenue changes relative to population changes. As population increases, it may be expected that the need for services would increase proportionately and, therefore, the level of per capita revenue should remain at least constant in real terms. If per capita revenue is decreasing, it would be expected that the City would be unable to maintain existing service levels unless it were to find new revenue sources or financial savings, assuming cost of service correlates to population.

Analysis

Net constant dollar revenue per capita (non-enterprise operations) decreased after 9/11 and has rebounded well since 2003. The decline and subsequent rebound can be tied to the economic recession and recovery at the national and state levels. Also, the 2005 operating revenue increase reflects new public safety tax approved by voters in 2004, which has an impact on several other trend indicators, as discussed throughout this report.

(in constant dollars)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Operating Revenue	\$283,581	\$281,909	\$301,690	\$348,914	\$382,549
Consumer Price Index	178.2	182.1	186.1	191.7	199.0
Current Population	210	214	218	221	226
Net Constant Dollar Revenue Per Capita	\$758	\$723	\$745	\$823	\$849

Sources: FYE 2002 - 2004 CAFR Table IV. FYE 2005-2006 CAFR Statements. All years - US Bureau of Labor Statistics for All Urban Consumers.

Calculation: Operating Revenue/CPI/Population (*100)

REVENUE

Elastic Tax Revenue

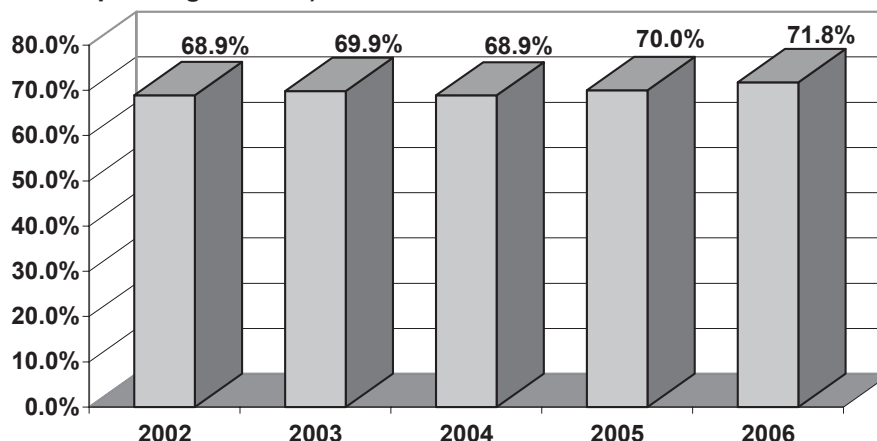
Description

Elastic revenues are highly responsive to changes in the economy and inflation. As the economy grows and inflation increases, elastic revenues increase in approximately the same proportion, and vice versa. For example, sales tax revenues rise and fall with increases and decreases in retail sales and corresponding economic growth or retrenchment. Inelastic revenues, such as fixed license fees or user charges, are relatively unresponsive to changes in economic conditions. The following City revenues fall within the elastic revenue category: Sales Tax, Transient Occupancy Tax (hotel/motel tax), State-Shared Sales Tax, State Revenue Sharing, Auto Lieu Tax, Highway User Tax (fuel tax), State-Shared Transit Revenue, Local Transportation Assistance Fund Revenue (Lottery), and Development Permits and Fees.

Analysis

Scottsdale's elastic tax revenue as a percent of net operating revenue remained consistent over the five-year period. Elastic revenues began rebounding with the economy in 2003. 2005 results include an increase in the tax rate approved by voters to support public safety services. Scottsdale's heavy reliance upon elastic revenue sources places a higher degree of risk upon the City's ability to maintain services during economic downturns. However, Scottsdale has a well-diversified General sales tax base that helps mitigate revenue declines during economic downturns. Tax base diversity includes Automotive, Construction, Food Stores, Hotel/Motel, Major Department Stores, Miscellaneous Retail, Rental, Restaurants, Utilities, and Other Taxable Activity.

(as % of operating revenue)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Elastic Tax Revenues	\$195,314	\$196,920	\$207,742	\$244,273	\$274,500
Net Operating Revenue	\$283,581	\$281,909	\$301,690	\$348,914	\$382,549
Percent Elastic Tax/ Net Operating Revenue	68.9%	69.9%	68.9%	70.0%	71.8%

Sources: FYE 2002-2004 CAFR Table IV; Statement of Revenues, Expenditures, and Changes in Fund Balance-Governmental Funds. FYE 2005-2006 CAFR Statements.

Calculation: Elastic Tax Revenues/Operating Revenue (*100)

REVENUE

Property Tax Revenue

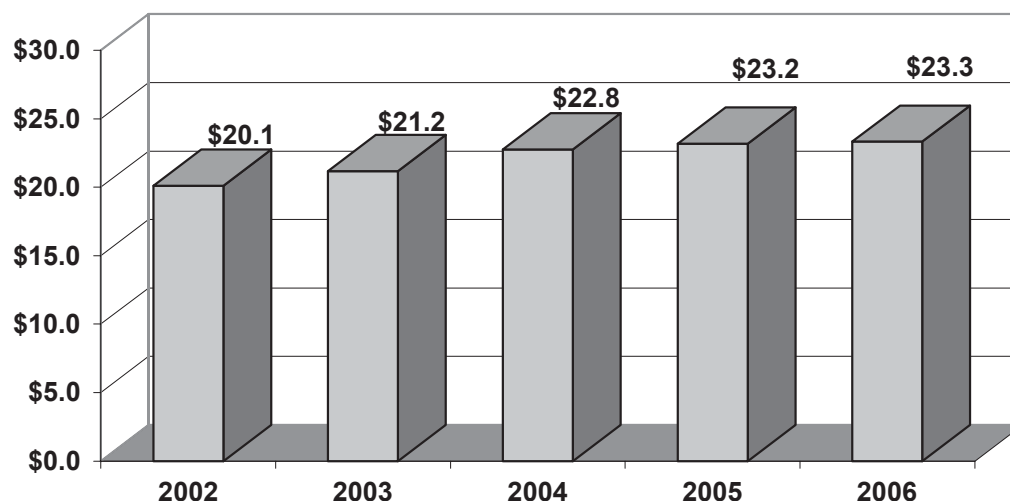
Description

Property tax is an important revenue source to consider when evaluating financial condition. Property tax revenue represents the City's second largest revenue source next to City sales tax revenue. There are two main components of property tax. Primary property taxes are levied for maintenance and operations of the City and secondary property taxes are levied solely for debt retirement. In contrast to sales taxes, property taxes are relatively inelastic due to a State imposed 2.0 percent annual levy limitation on the primary property tax rate.

Analysis

Despite consecutive year reductions in property tax rates, current year property tax revenues continue to increase, primarily due to assessed value growth and new construction added to the tax roles. Property tax revenue may also increase depending on future voter-approved debt issuances for capital improvements and related changes in Scottsdale's secondary tax rates.

Millions (in constant dollars)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Property Tax Revenue	\$35,859	\$38,582	\$42,377	\$44,464	\$46,431
Consumer Price Index	178.2	182.1	186.1	191.7	199.0
City Property Tax Rate	1.1866	1.1525	1.1529	1.1207	1.0702
Constant Dollar Property Tax Revenue	\$20,123	\$21,187	\$22,771	\$23,195	\$23,332

Sources: CAFR Table VII Total Tax Collections. FYE 2002-2004 CAFR Tables IX and Xia. FYE 2005-2006 CAFR Table X. All years - US Bureau of Labor Statistics for All Urban Consumers.

Calculation: Property Tax Revenue/CPI (*100)

*Property Tax Rates per \$100 Assessed Valuation.

REVENUE

Uncollected Property Taxes

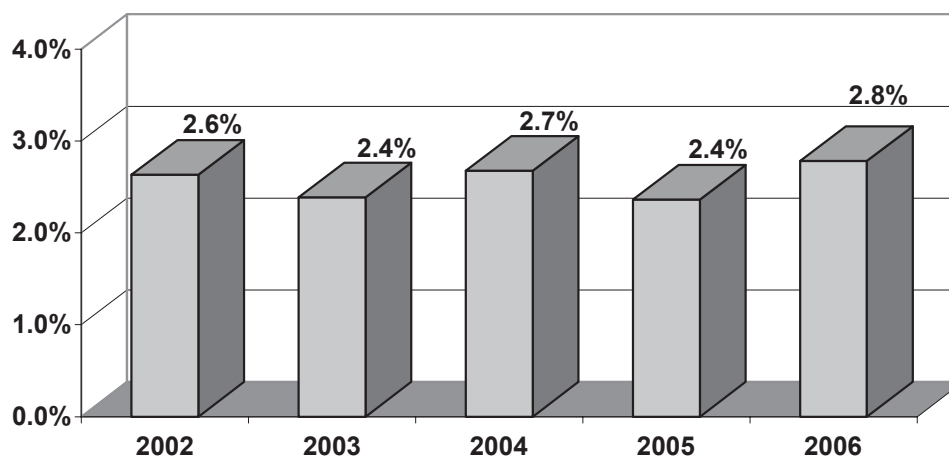
Description

A certain percentage of property taxes are not collected because of certain property owners' inability to pay, deficiencies in collection methods, policies and procedures, or a declining economy. The credit rating agencies consider an uncollectible rate of 2 or 3 percent per year normal. If the delinquency rate rises for two consecutive years or to more than 5 to 8 percent, it may signal potential problems in the stability of the property tax base or collection methods.

Analysis

Maricopa County collects and distributes property taxes to the City. Uncollected property taxes as a percentage of the total property tax levy have remained relatively constant over the measured period, resulting in an overall neutral trend. The uncollected percentage is within bond rating agency benchmarks and does not signal an alarming trend.

(as % of total levy)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Uncollected Property Taxes	\$952	\$935	\$1,143	\$1,057	\$1,325
Net Property Tax Levy	\$36,166	\$39,159	\$42,756	\$44,731	\$47,659
Percent Uncollected Property Taxes/Tax Levy	2.6%	2.4%	2.7%	2.4%	2.8%

Sources: CAFR Table X (Table IX FYE 2002-2004).

Calculation: Uncollected Property Taxes/Net Property Tax Levy (*100)

REVENUE

Intergovernmental Revenue

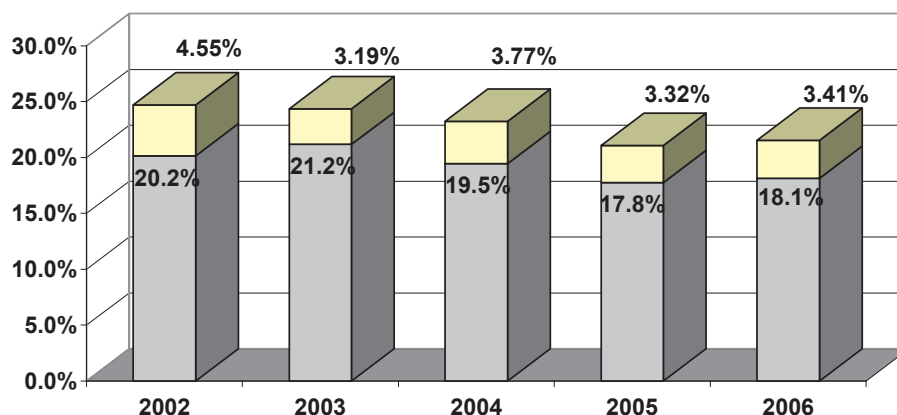
Description

Intergovernmental revenues are received from other governmental entities. An overdependence on intergovernmental revenues can have an adverse impact on financial condition due to restrictions or stipulations that the other governmental entity attaches to the revenue. The overriding concern in analyzing intergovernmental revenues is to determine whether the City is controlling its use of the revenues or whether these revenues are controlling the City.

Analysis

Generally, Scottsdale is not becoming overly dependent on intergovernmental revenue sources that, if reduced, could have an adverse impact on financial condition. Intergovernmental revenues as a percentage of operating revenues have remained relatively stable over the measurement period. The decrease in 2005 is primarily due to the increase in operating revenues related to the tax rate approved by voters to support public safety services.

(as % operating revenue)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Intergovernmental Revenue	\$57,152	\$59,694	\$58,716	\$61,948	\$69,413
(Excluding Grant Revenue)					
Grant Revenue	\$12,892	\$9,001	\$11,366	\$11,581	\$13,052
Operating Revenue	\$283,581	\$281,909	\$301,690	\$348,914	\$382,549
Percent Intergovernmental of Gross Operating Revenue	20.2%	21.2%	19.5%	17.8%	18.1%
Percent Grant Revenue of Gross Operating Revenue	4.5%	3.2%	3.8%	3.3%	3.4%

Sources: FYE 2002-2004 CAFR Table IV; Statement of Revenues, Expenditures, and Changes in Fund Balance-Governmental Funds. FYE 2005-2006 CAFR Statements.

Calculations: Intergovernmental Revenues/Operating Revenues (*100), Grant Revenues/Operating Revenues (*100).

REVENUE

User-Charge Coverage

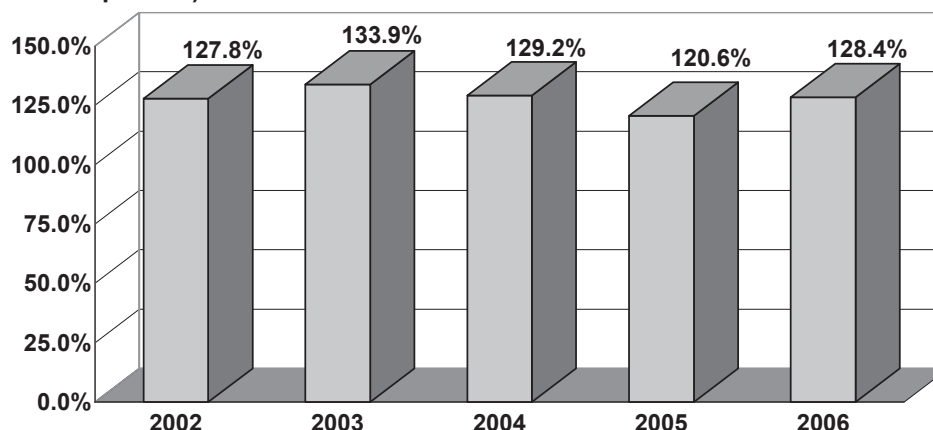
Description

User-charge coverage refers to whether user fees and charges recover the cost of providing a service. Cost recovery from user fees and charges applies to the City's enterprise operations: Water and Wastewater, Solid Waste, and Aviation. User fees and charges are established in Enterprise Funds to promote efficiency by shifting payment of costs to specific users of services and to avoid general taxation. Moderate rate increases are included as part of the budget to offset inflationary operating cost increases, mandated (and often unfunded) environmental standard compliance, and pay-as-you-go capital costs attributable to repair and replacement of infrastructure. Service costs, user fees and charges should be reviewed and adjusted where necessary to maintain cost recovery.

Analysis

On a combined basis (Water and Wastewater, Solid Waste, and Aviation), the user-charge coverage ratio maintained a neutral trend over the five-year period, indicating prudent management practices of balancing incremental fee increases with rising operating and capital costs. Fees and user charges in excess of related service expenditures are planned for debt retirement, pay-as-you-go capital expenditures, or retained for future repair and replacement and/or peaks in projected operating costs.

(as % of expenses)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Fees and User Charges	\$109,566	\$112,288	\$116,323	\$121,082	\$129,827
Related Service Expenses	\$85,727	\$83,884	\$90,067	\$100,383	\$101,146
Percent Coverage User Fees/ Enterprise Expenditures	127.8%	133.9%	129.2%	120.6%	128.4%

Sources: FYE 2002-2004 Statement of Revenues, Expenses and Changes in Fund Net Assets-Proprietary Funds. FYE 2005-2006 CAFR Statements.

Calculation: Fees & User Charges/Related Service Expenses (*100)

REVENUE

Restricted Revenue

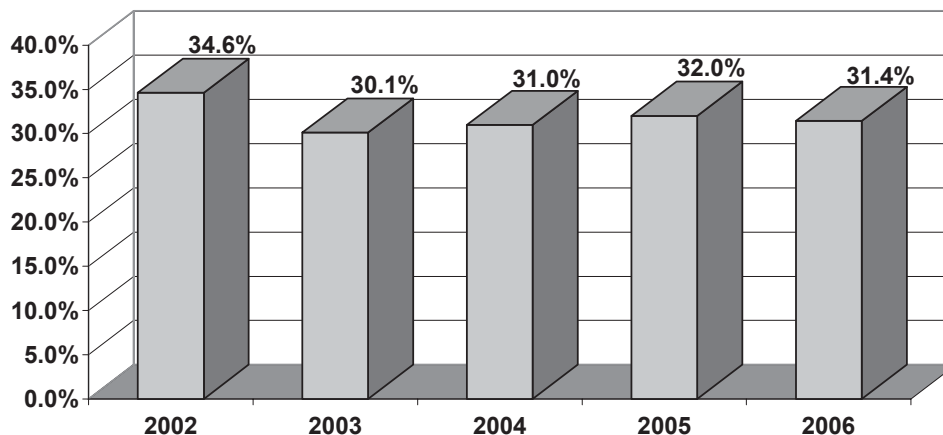
Description

Restricted revenue is legally earmarked for specific use, as may be required by State law, bond covenants, or grant requirements. For example, the State of Arizona requires that gas tax revenue be used only for street maintenance or construction. As the percentage of restricted revenue increases, the City loses its flexibility to respond to changing conditions. The overdependence on restricted revenues makes the City's programs vulnerable to dictates by the funding agencies and may signal a future inability to maintain current service levels at the least.

Analysis

The restricted revenue experienced an increase in 2005 due in large part to the new public safety sales tax approved by voters in 2004. The 2002 increase primarily relates to increases in grant awards for buses and police programs. Scottsdale's restricted revenue is composed primarily of property taxes and special assessment collections, both of which are levied by the City and are secured by real property and the dedicated preserve and transportation sales tax. The remaining restricted revenue is received from grants, gas tax revenue and lottery funds.

(as % of operating revenue)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Restricted Operating Revenue	\$98,222	\$84,872	\$93,425	\$111,690	\$120,303
Operating Revenue	\$283,581	\$281,909	\$301,690	\$348,914	\$382,549
Percent Restricted/Net Operating Revenue	34.6%	30.1%	31.0%	32.0%	31.4%

Sources: FYE 2002-2004 Combining Statement of Revenues, Expenditures in Fund Balance for Non-Major Governmental Funds and General Obligation Bond Debt Service. FYE 2005-2006 CAFR Statements.

Calculation: Restricted Operating Revenue/Operating Revenue (*100)

EXPENDITURES

Expenditures

Expenditures are an approximate measure of the City's service output. Generally, the more the City spends in constant dollars, the more service it is providing. This reasoning does not account for service delivery efficiency and effectiveness.

The first issue to consider is the expenditure growth rate to determine whether the City is operating within its revenues. Since the City of Scottsdale is required to have a balanced budget, it would seem unlikely that expenditure growth would exceed revenue growth. Nevertheless, the City may balance its annual budget yet create a long-run imbalance in which expenditure outlays and commitments grow faster than revenues. Some of the more common ways in which this happens are to use bond proceeds for operations, use reserve funds, and defer maintenance on streets, buildings, or other capital stock, or by deferring funding of contingent liabilities. In each of these cases, the budget remains balanced, but the long-run budget is developing a deficit.

A second issue to consider is the level of mandatory or fixed costs. This is also referred to as expenditure flexibility, which is a measure of the City's freedom to adjust its service levels to changing economic, political, and social conditions. A city with a growing percentage of mandatory costs will find itself proportionately less able to make adjustments. As the percentage of debt service, matching requirements, pension benefits, State and Federal mandates, contractual agreements, and commitments to existing capital plant increase, the flexibility to make spending decisions decreases.

Ideally, the City will have an expenditure growth rate that does not exceed its revenue growth rate and will have maximum spending flexibility to adjust to changing conditions. Analyzing the City's expenditure profile will help identify the following types of problems:

- Excessive growth of overall expenditures as compared to revenue growth in community wealth.
- An undesired increase in fixed costs.
- Ineffective budget controls.
- A decline in personnel productivity.
- Excessive growth in programs that create future expenditure liabilities.

The indicators detailed on the following pages can be used to monitor changes in expenditures.

EXPENDITURES

Expenditures Per Capita

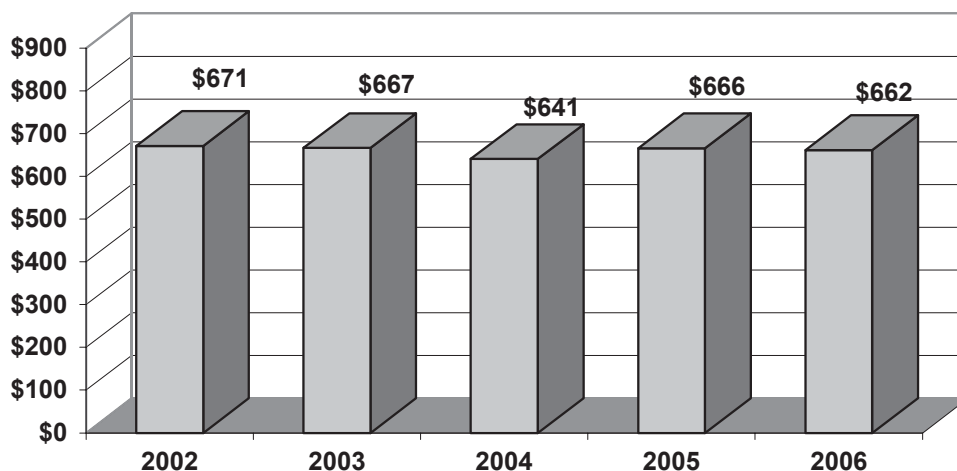
Description

Per capita expenditures reflect changes in expenditures relative to changes in population. Increasing per capita expenditures may indicate that the cost of providing services is outstripping the City's ability to pay, especially if spending is increasing faster than the City's property, sales, or other relevant tax base. If the increase in spending is greater than would be expected from continued inflation and cannot be explained by the addition of new services, it can be an indicator of declining productivity.

Analysis

The City's expenditures per capita (non-enterprise operations) trended downward between 2002 and 2004, reflecting cost saving measures and a rigorous budget development process. The increase in expenditures per capita in 2005 is a result of increased public safety efforts related to the 2004 sales tax approved by voters, as well as one-time start-up costs for the new municipal fire department. 2006 reflects greater-than-expected year-end department savings primarily related to contractual and personal services.

(in constant dollars)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Operating Expenditures	\$251,142	\$259,960	\$259,378	\$282,269	\$298,049
Consumer Price Index	178.2	182.1	186.1	191.7	199.0
Current Population	210	214	218	221	226
Net Constant Dollar					
Expenditures Per Capita	\$671	\$667	\$641	\$666	\$662

Sources: FYE 2002-2006 CAFR Statement of Revenues, Expenditures, and Changes in Fund Balance-Governmental Funds and Non-Major Funds. All years - US Bureau of Labor Statistics for All Urban Consumers

Calculation: Net Expenditures/CPI/Population (*100)

EXPENDITURES

Operating Expenditures – Service Areas

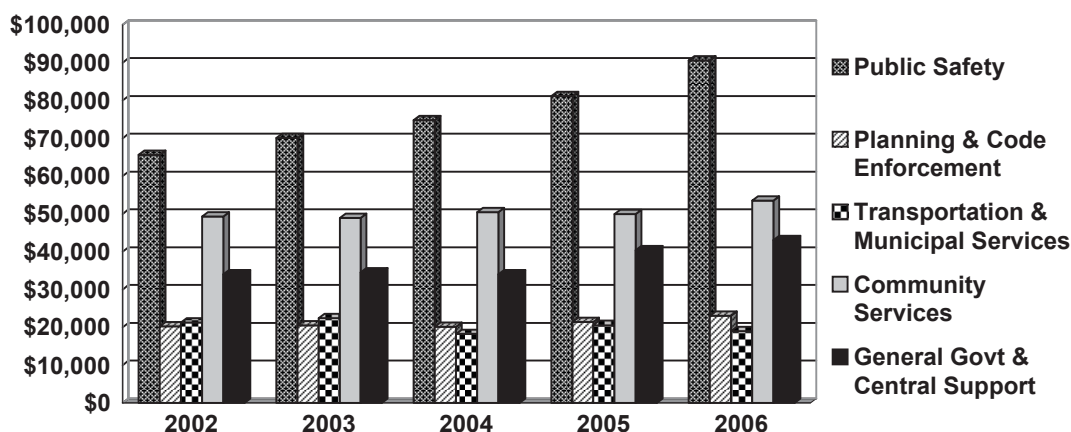
Description

Tracking a city's operating expenditures by service areas can be a useful tool in analyzing developing trends that may indicate need for further attention or resources. Shifting trends may reflect a city's efforts to address goals and objectives, specific needs of the community, or may indicate an underlying problem that requires a shift in focus and/or resources.

Analysis

The City's operating expenditures by service area (Governmental Funds) over the five-year period reflect requested service level needs by the community, as well as increased operating costs related to both new and current capital facilities. The year-over-year increases to Public Safety (Police and Fire) expenditures can be attributed to general inflationary costs related to City operations, the addition of a new municipal fire department, and increased service level demands by the community, as reflected by the voter-approved 2004 Public Safety Sales Tax. Expenditures by individual service area do not reflect net constant dollars.

(in thousands)



(in thousands)

	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Public Safety	\$65,643	\$70,116	\$74,775	\$81,194	\$90,574
Planning & Code Enforcement	\$20,275	\$20,460	\$20,171	\$21,448	\$23,016
Transportation & Public Works	\$21,230	\$22,422	\$18,173	\$20,573	\$18,949
Community Services	\$49,276	\$48,950	\$50,494	\$49,941	\$53,535
General Govt & Central Support	\$34,043	\$34,523	\$33,961	\$40,359	\$43,045
Total Expenditures (Constant Dollars)	\$106,884	\$107,892	\$106,166	\$111,380	\$115,135

Sources: FYE 2002-2006 CAFR Statement of Revenues, Expenditures, and Changes in Fund Balance (Governmental Funds).

EXPENDITURES

Employees Per Capita

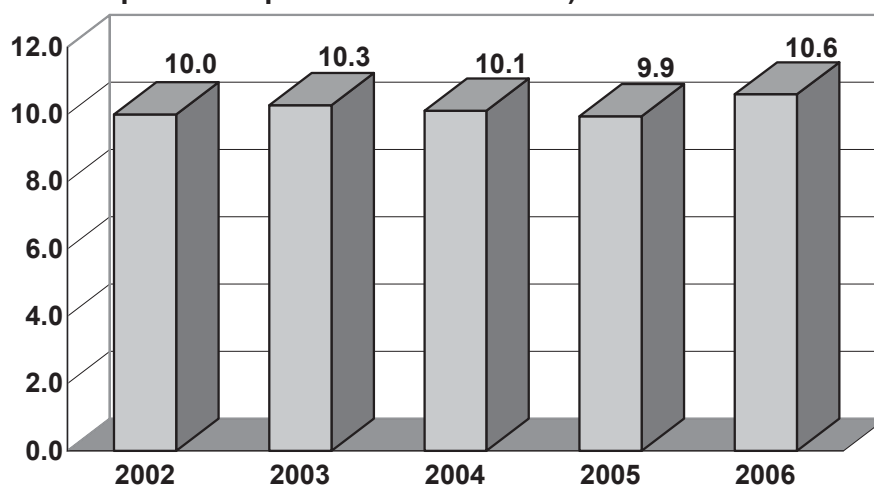
Description

Personnel costs are a major portion of the City's operating budget. Tracking changes in the number of employees to population is a means to measure changes in expenditures. An increase in employees to population may indicate that expenditures are rising faster than revenues, the City is becoming more labor intensive, or that productivity is declining.

Analysis

Full Time Equivalents (FTEs) include full time, part time, and grant funded employees. The overall flat five-year trend for FTE ratio per 1,000 citizens indicates personnel growth is not outstripping growth in public service levels. The trend suggests that the City is providing increased service levels and productivity while not becoming more labor intensive. Due to earlier economic slowdown, the City began evaluating all new positions authorized by the budget and those open due to attrition, prior to recruitment.

(full-time equivalents per thousand citizens)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Full-Time Equivalents (FTE)	2.1	2.2	2.2	2.2	2.4
Population	210	214	218	221	226
Full-Time Equivalents Per 1,000 Citizens	10.0	10.3	10.1	9.9	10.6

Sources: City of Scottsdale Annual Adopted Budgets. CAFR Statements.

Calculation: FTE/Population (*1000)

EXPENDITURES

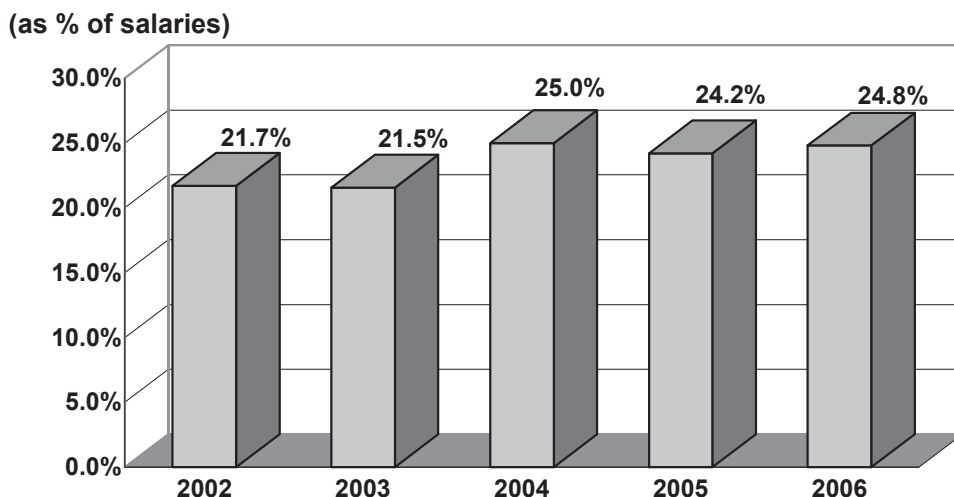
Fringe Benefits

Description

Fringe benefits comprise a significant portion of operating costs. Direct fringe benefits requiring an immediate cash outlay include Social Security taxes, retirement system contributions, worker's compensation, life and health insurance, tuition reimbursement, and vehicle allowances. Indirect benefits, which include accumulated holiday, vacation, and sick leave, do not require immediate cash outlay but may require paying the opportunity cost of not having the work done or paying others to do the work.

Analysis

Fringe benefits as a percentage of salaries trended upward from over the five-year period and remained within the standard range for government industry benchmarks. The increasing trend is attributable to rising health care costs, Social Security taxes and retirement system contributions, all of which are nationwide trends.



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Fringe Benefit Expenditures	\$20,964	\$22,478	\$26,366	\$27,395	\$34,247
Salaries and Wages	\$96,697	\$104,316	\$105,567	\$113,256	\$138,106
Percent Fringe Benefits/ Salaries and Wages	21.7%	21.5%	25.0%	24.2%	24.8%

Sources: FYE 2002-2004 Payroll schedule with salaries and fringe benefits (establishes percent based on payroll input). FYE 2005-2006 General Ledger Expenditures.

Calculation: Fringe Benefits/Salaries and Wages (*100)

OPERATING POSITION

Operating Position

Operating position refers to the City's ability to balance its budget on a current basis, maintain reserves for emergencies, and maintain sufficient cash to pay its bills on a timely basis.

During a typical year, a city will usually generate either an operating surplus, when revenues exceed expenditures, or an operating deficit, when expenditures exceed revenues. An operating surplus or deficit may be created intentionally as a result of a conscious policy decision, or may be created unintentionally because it is difficult to precisely forecast revenues and expenditures. When deficits occur, they are usually funded from accumulated fund balances; when surpluses occur, they are usually dedicated to building prior years' fund balances or to funding future years' operations.

Reserves are built through the accumulation of operating surpluses. Reserves are maintained for the purposes of financial security in the event of loss of a revenue source, economic downturn, unanticipated expenditure demands due to natural disasters, insurance loss, need for large-scale capital expenditures or other non-recurring expenses, or uneven cash flow.

Sufficient cash, or liquidity, refers to the flow of cash in and out of the City treasury. The City receives many of its revenues in large installments at infrequent intervals during the year. It is to the City's advantage to have excess liquidity or cash reserves as security in the event of an unexpected delay in receipt of revenues, an unexpected decline or loss of a revenue source, or an unanticipated need to make a large expenditure.

An analysis of operating position can help identify the following situations:

- Emergence of operating deficits.
- Decline in reserves.
- Ineffective revenue forecasting techniques.
- Ineffective budgetary controls.
- Inefficiencies in management of enterprise operations.

The indicators detailed on the following pages can be used to monitor changes in operating position.

OPERATING POSITION

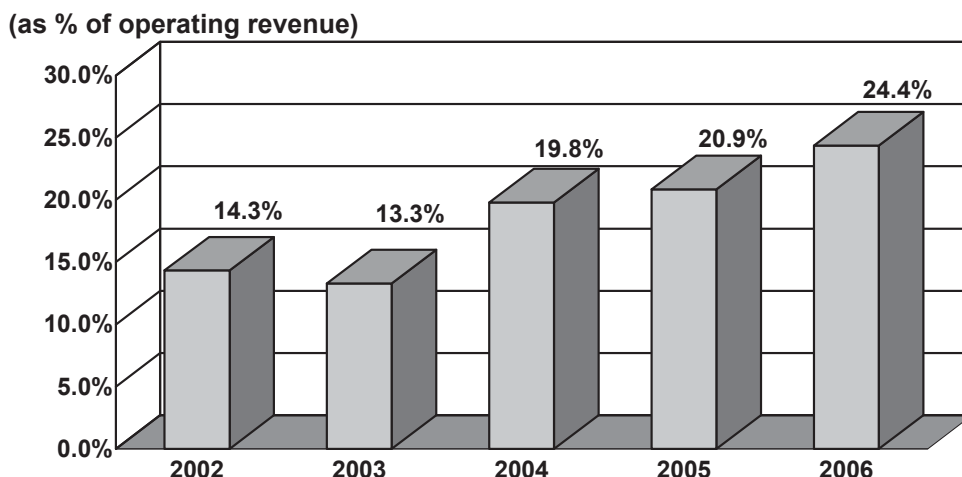
General Fund Balance

Description

The level of fund balances may determine the City's ability to withstand unexpected financial emergencies that may result from natural disasters, revenue shortfalls, or steep rises in inflation. Fund balances may also determine the City's ability to accumulate funds for large-scale purchases without having to borrow. Unrestricted fund balance includes financial policy designated reserves, contingencies, and unreserved fund balances.

Analysis

Scottsdale's unrestricted fund balance as a percent of operating revenue fluctuated slightly over the measured period and recent trend is very positive. Despite the economic slowdown experienced in fiscal years 2002 and 2003, the unrestricted General Fund Balance as a percentage of operating revenue declined only 1.0 percent over the two-year period, reflecting conservative budgeting and spending. The increase since 2003 is result of the improving economy, higher actual revenues than forecast, and better-than-expected year-end department savings. Approximately \$45.4 million of fiscal year-end 2006 balance planned for one-time pay-as-you-go CIP expenditures in FY 2006/07 budget.



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Unrestricted Fund Balance	\$40,643	\$37,516	\$59,707	\$72,772	\$93,243
Operating Revenue	\$283,581	\$281,909	\$301,690	\$348,914	\$382,549
Percent Fund Balance/ Fund Operating Revenue	14.3%	13.3%	19.8%	20.9%	24.4%

Sources: FYE 2001-2006 General Fund Unreserved Fund Balance-Governmental Funds Balance Sheet; Table IV.

Calculation: Unrestricted/Operating Revenue (*100)

OPERATING POSITION

Enterprise Fund Operating Margin

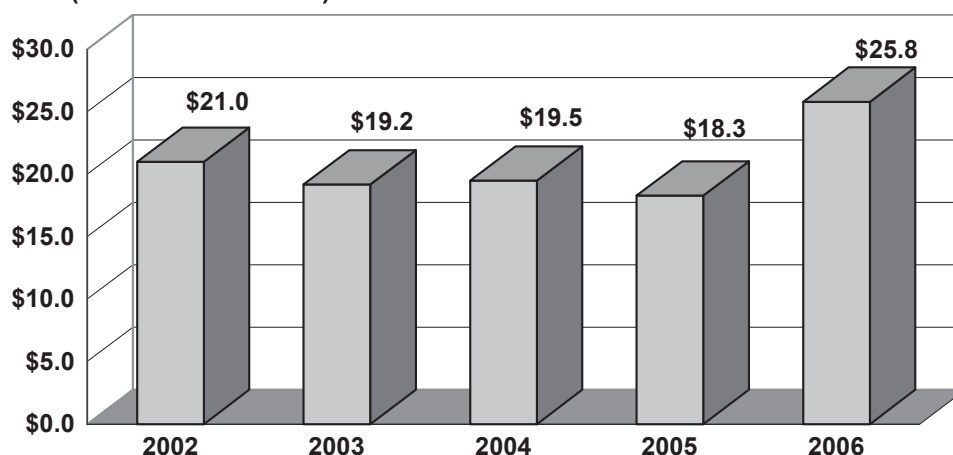
Description

Enterprises are expected to function as if they were a commercial “for profit” entity and supported by user fees as opposed to a governmental “not for profit” entity supported by taxes. In times of financial strain, a city can raise taxes to increase support for governmental programs. User fees and charges are established in Enterprise Funds to promote efficiency by shifting payment of costs to specific users of services and to avoid general taxation. Moderate rate increases are included as part of the budget to offset increasing operating costs, mandated (and often unfunded) environmental standard compliance, and pay-as-you-go capital costs attributable to repair and replacement of infrastructure. Positive operating results allow the Enterprise Funds to stabilize rates even in years where large capital expenditures must be made, e.g., the construction of a new plant.

Analysis

The decline in operating results beginning in 2002 was primarily due to investment earnings decrease from the investment market downturn related to the 9/11 terrorist attacks. The economic downturn continued into 2003 with a further reduction in investment earnings of \$4.3 million, partially offset by rate and fee adjustments. Fluctuations for 2004 – 2006 reflect normal forecast versus actual variances, primarily due to the impacts of weather and rainfall on the water and sewer fund revenues.

Millions (in constant dollars)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Enterprise Operating Margin	\$37,398	\$34,924	\$36,266	\$35,045	\$51,332
Consumer Price Index	178.2	182.1	186.1	191.7	199.0
Net Constant Dollar					
Enterprise Fund Earnings	\$20,987	\$19,178	\$19,487	\$18,281	\$25,795

Sources: FYE 2002-2006 CAFR Statement of Revenues, Expenses, and Changes in Fund Net Assets-Proprietary Funds - Operating income (loss) LESS depreciation PLUS interest income (expense) PLUS operating transfers. All years-US Bureau of Labor Statistics for All Urban Consumers

Calculation: Enterprise Results/CPI (*100)

OPERATING POSITION

Liquidity

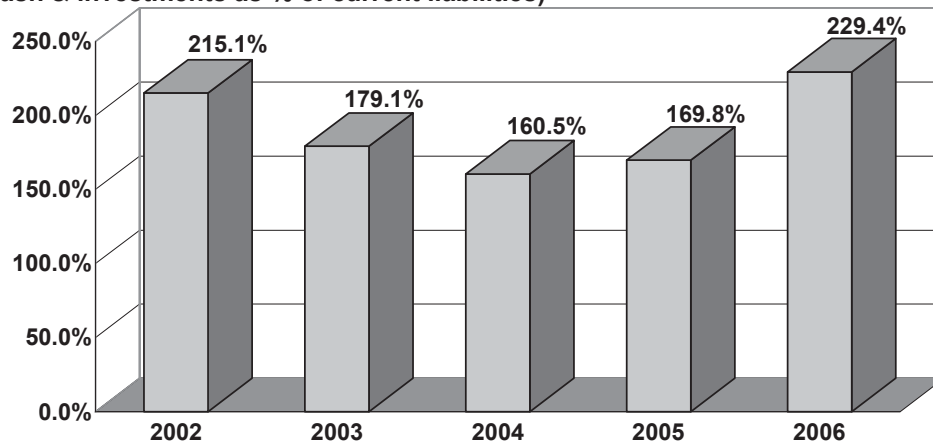
Description

A measure of the City's short-run financial condition is its cash position. Cash position includes cash on hand and in the bank, as well as other assets that can be easily converted to cash, such as short-term investments. The level of this type of cash is referred to as liquidity. Liquidity measures the City's ability to pay its short-term obligations. Low or declining liquidity can indicate that the City has overextended itself in the long term.

Analysis

The liquidity ratio has remained well over 100.0 percent over the measured period, which would be termed a current account surplus. The liquidity ratio indicates that the City's ability to pay short-term obligation is excellent. In fiscal year 2003, the liquidity ratio declined to 179.1 percent due to deferral of special assessment revenue, debt service principal and interest payments that were accrued. In fiscal year 2004, the major decrease was due to the defeasance of Municipal Property Corporation (Asset Transfer) debt using general funds. The sharp increase in 2006 can be attributed to strong revenue gains due to economic growth, as well as higher interest rates on short-term investments.

(cash & investments as % of current liabilities)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Cash and Investments	\$149,096	\$146,443	\$127,526	\$135,878	\$191,266
Current Liabilities	\$69,301	\$81,744	\$79,464	\$80,029	\$83,373
Percent Cash and Investments/ Current Liabilities	215.1%	179.1%	160.5%	169.8%	229.4%

Sources: FYE 2002-2006 Balance Sheet-Governmental Funds and NonMajor Governmental Funds.

Calculation: Investments/Liabilities (*100)

DEBT STRUCTURE

Debt Structure

Debt structure is important because debt is an explicit expenditure obligation that must be satisfied when due. Debt can be an effective tool to finance capital improvements and to smooth out short-term revenue flows; however, its misuse can cause serious financial problems. Even a temporary inability to repay debt can result in loss of credit rating, increased borrowing costs, and loss of autonomy to State and other regulatory bodies.

The most common forms of long-term debt are general obligation, special assessment, and revenue bonds. When the City issues debt for capital projects, it must ensure that aggregate outstanding debt does not exceed the community's ability to pay debt service as measured by the property value or personal or business income.

Under the most favorable circumstances, the City's debt should be proportionate in size and growth to the City's tax base; should not extend past the useful life of the facilities which it finances; should not be used to balance the operating budget; should not require repayment schedules that put excessive burdens on operating expenditures; and should not be so high as to jeopardize the City's credit rating.

An examination of the City's debt structure can reveal the following conditions:

- Inadequacies in cash management procedures.
- Inadequacies in expenditure controls.
- Decreases in expenditure flexibility due to increased fixed costs in the form of debt service.
- Use of short-term debt to finance current operations.
- Existence of sudden large increases or decreases in future debt service.
- The amount of additional debt that the community can absorb.

The indicators detailed on the following pages can be used to monitor changes in debt structure.

DEBT STRUCTURE

Net Direct Debt Per Assessed Valuation

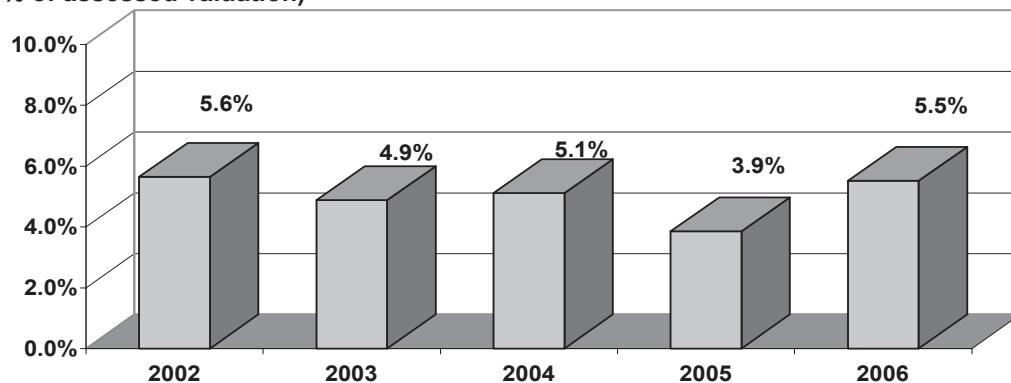
Description

Net direct debt is general obligation debt paid by secondary property tax levy, less self-supporting debt (e.g., enterprise and preserve debt) and current debt service reserves. The assessed value is the most generally available measure of community wealth. Generally, long-term debt should not exceed the City's resources for paying debt service.

Analysis

The percent of net direct long-term debt as a percent of assessed valuation reflected an overall downward trend for the measurement period. A growing city is expected to have associated debt burden to support its growing infrastructure needs. Current debt pay down, coupled with well-managed new debt issuances to support growing infrastructure needs has kept the direct debt to citizens affordable. On average, assessed value growth outpaced net direct long-term debt growth over the measured period. This, coupled with strong personal income levels, indicates the community's increasing ability to pay for the City's required debt obligations. Increases in 2004 and 2006 primarily due to new Bond 2000 debt issuances to support planned capital improvement projects.

(as % of assessed valuation)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
General Obligation Debt*	\$193,384	\$181,000	\$206,655	\$187,940	\$299,650
Less: General Obligation Bond					
Debt Service Reserve	(\$8,449)	(\$9,006)	(\$3,469)	(\$5,602)	(\$12,436)
Net Direct Long-Term Debt*	\$184,935	\$171,994	\$203,186	\$182,338	\$287,214
Assessed Valuation	\$3,277,951	\$3,526,605	\$3,975,522	\$4,735,691	\$5,209,444
Percent Net Direct Debt/ Assessed Valuation	5.6%	4.9%	5.1%	3.9%	5.5%

Sources: FYE 2002-2006 CAFR Schedule of Changes in Long-term Debt; Statement of Revenues, Expenditures, and Changes in Fund Balances.

Calculation: Net Direct Long-Term Debt/Assessed Valuation (*100)

*The City's Preservation General Obligation Bonds are excluded from Net Direct Long-Term Debt. The City intends to pay debt service on these bonds from the dedicated McDowell Mountain Preserve sales taxes approved by the voters in 1995 and 2004.

DEBT STRUCTURE

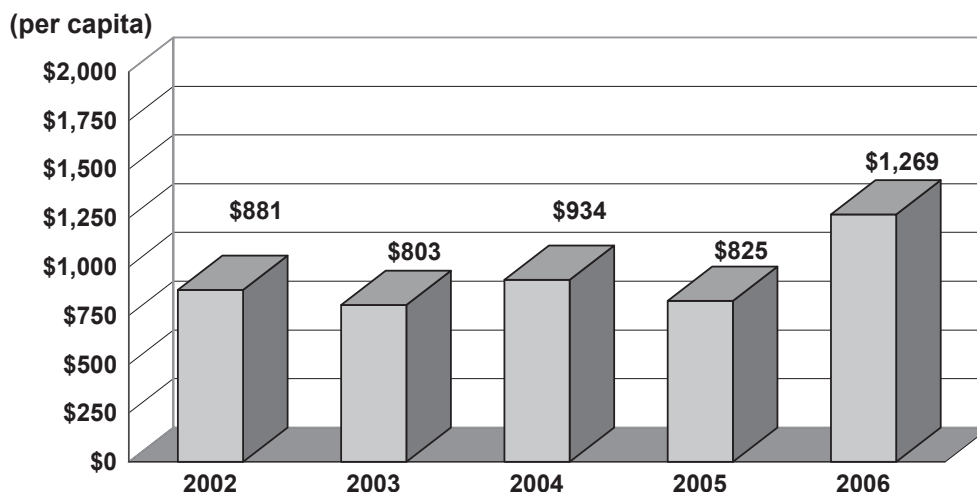
Net Direct Debt Per Capita

Description

Net direct debt is general obligation debt paid by secondary property tax levy, less self-supporting debt (e.g., enterprise and preserve debt) and current debt service reserves. The net direct debt per capita measure illustrates how the growth in debt is changing relative to population changes. As population increases it would be expected that capital needs and the associated long-term debt would also increase. If long-term debt is increasing in the face of a stabilizing or declining population, debt levels may be reaching or exceeding the City's ability-to-pay.

Analysis

The level of net direct debt per capita reflects a rising trend due to the issuance of new general obligation debt approved by Scottsdale citizens. A city with a positive population trend is expected to have associated debt burden in order to finance infrastructure needs. As discussed in the analysis of Net Direct Debt Per Assessed Valuation, the City's assessed value growth exceeded net direct debt growth indicating the community's increasing ability to pay the obligations. Increases in 2004 and 2006 primarily due to new Bond 2000 debt issuances to support planned capital improvement projects.



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
General Obligation Debt*	\$193,384	\$181,000	\$206,655	\$187,940	\$299,650
Less: General Obligation Bond					
Debt Service Reserve	(\$8,449)	(\$9,006)	(\$3,469)	(\$5,602)	(\$12,436)
Net Direct Long-Term Debt*	\$184,935	\$171,994	\$203,186	\$182,338	\$287,214
Population	210	214	218	221	226
Net Direct Debt Per Capita	\$881	\$803	\$934	\$825	\$1,269

Sources: FYE 2002-2006 CAFR Schedule of Changes in Long-term Debt; Statement of Revenues, Expenditures, and Changes in Fund Balances.

Calculation: Net Direct Long-Term Debt/Population

*The City's Preservation General Obligation Bonds are excluded from Net Direct Long-Term Debt. The City intends to pay debt service on these bonds from the dedicated McDowell Mountain Preserve sales taxes approved by the voters in 1995 and 2004.

DEBT STRUCTURE

Overlapping Net Debt

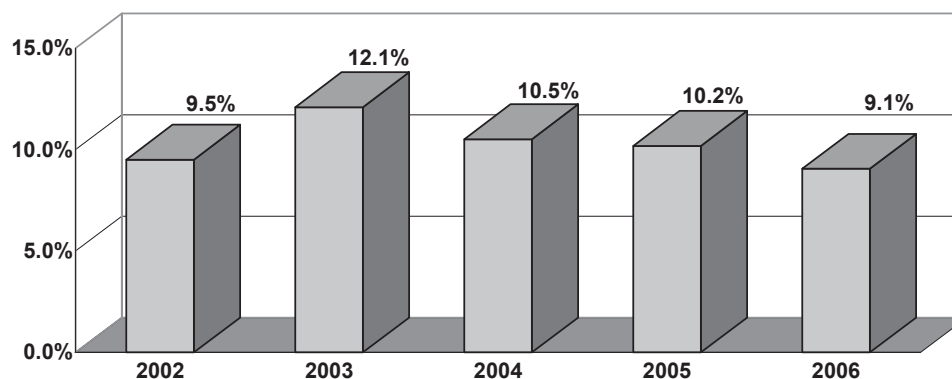
Description

Overlapping net debt is the net direct debt of all local government jurisdictions that is issued against a tax base within part or all of the geographic boundaries of the City. Examples of other jurisdictions that may overlap the City are Maricopa County, Maricopa County Community College District, Tempe, Paradise Valley, and Scottsdale school districts.

Analysis

The overlapping net debt as a percent of assessed valuation declined over the measurement period. 2002 results reflect repayment of debt issuances by the school districts. On average, the measured period showed a positive trend, as assessed value growth outstripped overlapping debt growth. For the future, the \$951 million bond election for Maricopa Community Colleges that was approved by voters in the November 2004 election may have an impact on overlapping net debt and could eventually result in a rising trend.

(as % of assessed valuation)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Overlapping Net Debt	\$311,465	\$426,474	\$417,824	\$482,045	\$471,837
Secondary Assessed Valuation	\$3,277,951	\$3,526,605	\$3,975,522	\$4,735,691	\$5,209,444
Percent Overlapping Net Debt/Assessed Valuation	9.5%	12.1%	10.5%	10.2%	9.1%

Sources: FYE 2002-2004 CAFR Table Xb and Table XVIII. FYE 2005-2006 CAFR Table XIII; City of Scottsdale, Financial Services Department.

Calculation: Overlapping Debt/Secondary Assessed Valuation (*100)

DEBT STRUCTURE

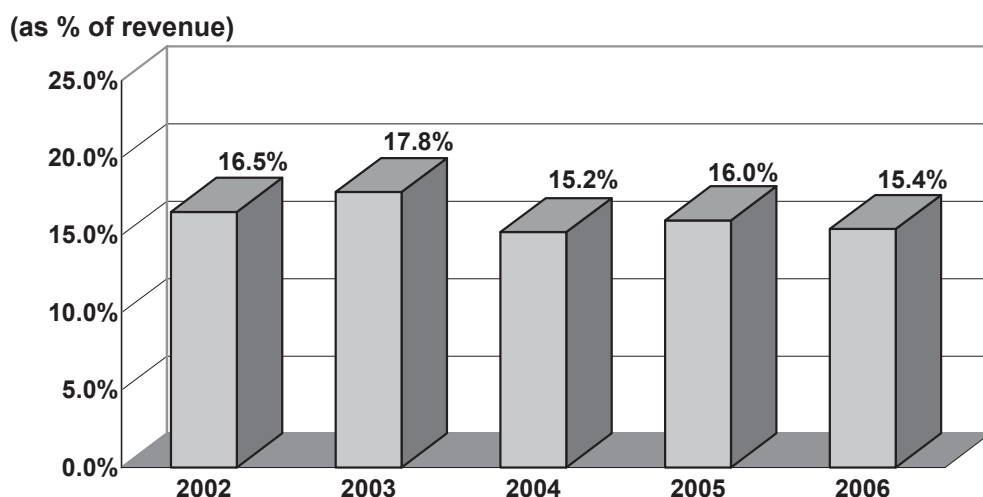
Debt Service

Description

Debt service is defined as the amount of principal and interest that the City must pay each year on long-term debt plus the interest it must pay on direct short-term debt. As the debt service increases, it adds to the City's obligations and reduces the City's expenditure flexibility. Debt service can be a major part of the City's fixed costs and its increase may indicate excessive debt and fiscal strain.

Analysis

The level of debt service as a percent of Governmental and Enterprise Fund operating revenues has remained relatively neutral for Scottsdale over the measurement period. During 2003, debt service expenditures increased due to the issuance of new debt and the decline in revenues related to the soft economy. As the economic rebound took hold in 2004, the higher revenues resulted in sufficient resources to meet growing service demands. Increased debt service in recent years attributable to bonds related to SkySong, WestWorld land, and Bond 2000 CIP program.



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Debt Service	\$64,967	\$69,662	\$63,308	\$76,289	\$79,689
Governmental/Enterprise Funds Revenue	\$393,598	\$391,657	\$416,415	\$477,762	\$517,331
Percent Debt Service/Total Operating Revenue	16.5%	17.8%	15.2%	16.0%	15.4%

Sources: FYE 2002-2006 CAFR Statement of Revenues, Expenditures and Changes in Fund Balance-Governmental Funds plus Debt Service and Reserve Actual Amounts - GAAP basis for all Enterprise Funds (Water, Solid Waste and Airport); amounts for Special Assessments, Scottsdale Mountain CFD, McDowell Mountain CFD, DC Ranch CFD, and Via Linda CFD are not included.

Calculation: Debt Service/Operating Revenue (*100)

DEBT STRUCTURE

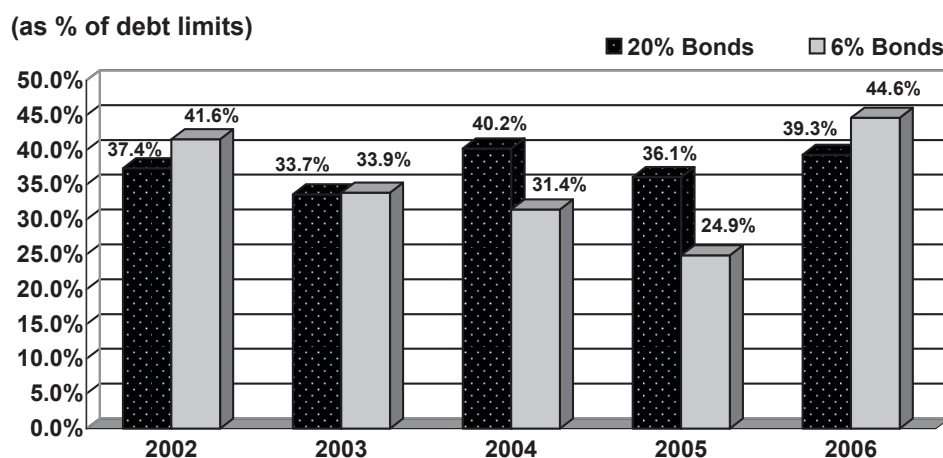
Debt Margin

Description

Under Arizona law, cities can issue general obligation bonds up to an amount not exceeding specific debt limits. General obligation bonds issued for purposes of water, wastewater, artificial light, open space preserves, parks, playgrounds, and recreational facilities cannot exceed 20 percent of assessed valuation. General obligation bonds issued for all other purposes cannot exceed 6 percent of assessed valuation. The debt margin is that portion of the legal debt limit available for bonding.

Analysis

The City's percent of debt outstanding as a percent of the legal debt limit for the five-year period shows an overall neutral trend for 20 percent bonds and an overall declining trend for 6 percent bonds. Increased activity for 6 percent bonds in 2006 is related to the new issuance that occurred in December 2005. Both debt margins are favorable, as the percent of debt outstanding is well within the debt limits. This indicates that the City has available capacity to issue additional general obligation bonds.



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
20% Debt Outstanding	\$245,209	\$237,400	\$319,765	\$313,786	\$372,545
20% Debt Limit	\$655,590	\$705,321	\$795,104	\$868,691	\$947,151
Outstanding Debt as a Percent of Debt Limit	37.4%	33.7%	40.2%	36.1%	39.3%
6% Debt Outstanding	\$81,757	\$71,695	\$74,984	\$64,799	\$126,820
6% Debt Limit	\$196,677	\$211,596	\$238,531	\$260,607	\$284,145
Outstanding Debt as a Percent of Debt Limit	41.6%	33.9%	31.4%	24.9%	44.6%

Sources: CAFR Table XIII (Table XV for FYE 2002-2004 and XIVa for FYE 2005-2006) Net Outstanding Bonded Debt Subject to 20% Limit/6% Limit; CAFR Table XIII (XV for FYE 2002-2004 and XIVa for FYE 2005-2006) Debt Limit Equal to 20% Assessed Value/6% Assessed Value.

Calculation: Debt Outstanding/Debt Limit (*100)

CONTINGENT LIABILITIES

Contingent Liabilities

A contingent liability is an existing condition or situation whose ultimate disposition may not be known or does not have to be paid until a future year, and for which reserves have been set aside. A contingent liability is similar to debt in that it represents a legal commitment to pay sometime in the future. Due to the potential magnitude, if these types of obligations grow substantially over time, they can have a significant impact on the City's financial condition.

The contingent liabilities considered here are significant because they are not readily apparent in ordinary financial records, making it difficult to assess their respective impacts. Additionally, the contingent liabilities may accumulate gradually over time, making it difficult to notice them until the problem is severe.

An analysis of the City's contingent liabilities can reveal the following:

- An increase in the City's pension liability.
- Inadequacies in pension plan contributions, pension system assets, and whether the investment earnings are keeping pace with the growth in benefits.
- An increasing amount of unused employee vacation and sick leave.
- Inadequacies of City policies for payment of unused vacation and sick leave as compared to the City's ability to pay.
- An increase in the amount of lawsuits and other claims against the City.

The indicators detailed on the following pages can be used to monitor changes in contingent liabilities.

CONTINGENT LIABILITIES

Pension Benefit Obligation

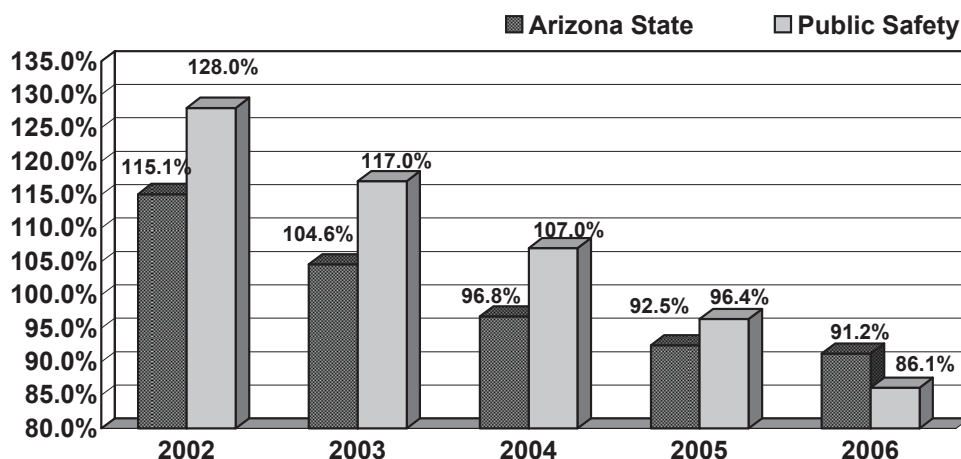
Description

Pension plans represent a significant expenditure for the City. There are two basic ways to fund pension plans: (1) Fund them when benefits need to be paid (pay-as-you-go), or (2) Fund them as benefits accrue and reserve cash for when benefits will have to be paid (full funding). The State of Arizona administers the pension plans that cover City employees and have required employee and employer contributions in order to fully fund all pension benefit obligations.

Analysis

Full funding of the Arizona State Retirement Plan and the Public Safety Retirement Plan has been a favorable trend over previous measurement periods. The decline in percent of benefits funded from fiscal year 2002 forward can be attributed to the downturn in the economy, sharply lower returns on investments, expanded coverage needs, and changing population demographics as average life expectancy increases. In light of this declining trend, increased contributions to the plans by employee and employer have been necessary to ensure continued funding.

(as % of pension benefit obligation)



Percent of Pension Benefit Obligation Funded	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Arizona State Retirement Plan (Other Employees)	115.1%	104.6%	96.8%	92.5%	91.2%
Public Safety Retirement Plan (Police Employees)	128.0%	117.0%	107.0%	96.4%	86.1%

Sources: The Arizona State Retirement System Comprehensive Annual Financial Report Schedule of Funding Progress; Public Safety Personnel Retirement System Comprehensive Financial Report Schedule of Funding Progress.

CONTINGENT LIABILITIES

Compensated Absences

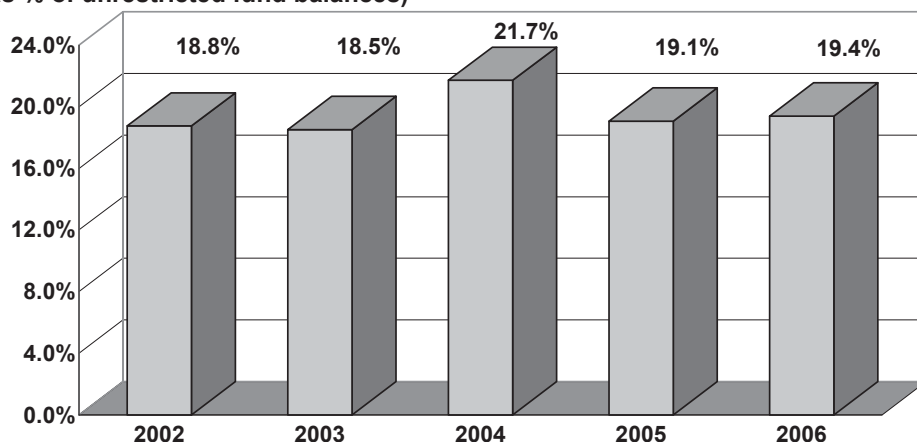
Description

Compensated absences consist of vacation accruals for active employees and medical leave conversion for retirees. These accumulated employee benefits are payable to the employee or retiree, subject to certain limitations, and represent an unfunded, long-term liability to the City.

Analysis

The City's liability for compensated absences has remained relatively consistent over the five-year period. Actuarial Studies have been used since fiscal year 2002 to determine the actual liability of a provision in the City Code that allows long-term employees to use unused sick leave to pay insurance premiums after retirement. The trend reflects increased wages, health insurance costs, and the aging employee population that is nearing retirement. Also, recent accounting policy changes increased the compensated absence balance at June 30, 2006, by matching the amount to be paid from current resources versus payments from future resources.

(as % of unrestricted fund balances)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Compensated Absences*	\$12,455	\$11,495	\$13,038	\$13,880	\$18,886
Unrestricted Governmental Fund Balances**	\$66,418	\$62,069	\$60,042	\$72,784	\$97,324
Percent Compensated Absence/Unrestricted Gov't Fund Balance	18.8%	18.5%	21.7%	19.1%	19.4%

*Compensated Absences, Governmental Activity LESS Compensated Absences, Special Revenues (all funds except HURF).

**Includes Governmental Funds and HURF. For FYE 6/02 and FYE 6/03, LESS MPC Asset Transfer Bonds (\$33,720.00).

Sources: CAFR "Schedule of Changes in Long-Term Debt"; Summary Trial Balance Reports for Special Revenues; CAFR "Balance Sheet, Governmental Funds"; and CAFR "Combining Balance Sheet, Nonmajor Special Revenue Governmental Funds"

Calculation: Compensated Absences/Fund Balance (*100)

CONTINGENT LIABILITIES

Self-Insurance

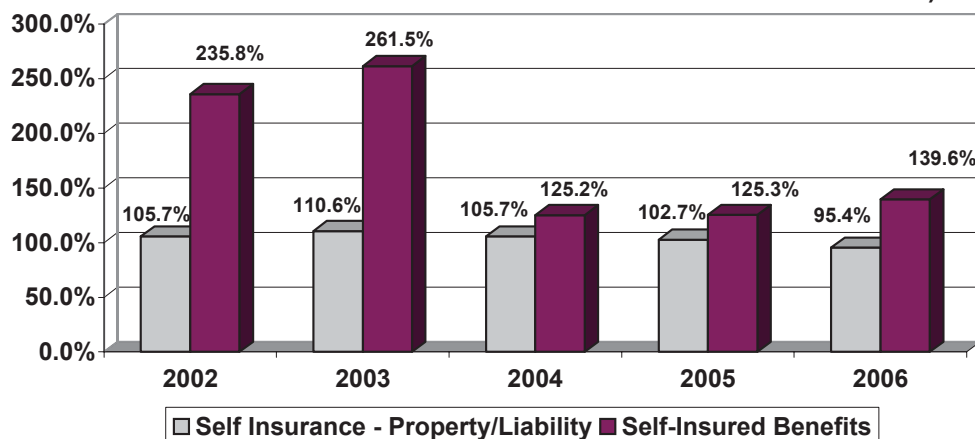
Description

The City is subjected to lawsuits and other claims occurring in the ordinary course of its operations. Since the City is largely self-insured, these potential and costs liabilities are to be paid from the fund balance established for self-insurance purposes. The City receives an actuarial study each year that outlines the recommended actuarial fund balance based on an estimate of outstanding losses. The self-insurance fund balance should be at a level sufficient enough to cover all estimated outstanding losses in the near-term.

Analysis

The self-insurance recommended fund balance reflected a neutral trend over the measured period. The increase in fiscal year 2004 was due to a series of severe workers' compensation claims. The benefit fund balance increased in 2004 with the change to fully self-insuring employee health benefits.

(self-insurance fund balance as % of recommended actuarial fund balance)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Property/Liability Balance	\$11,177	\$12,201	\$12,877	\$14,159	\$12,294
Recommended Fund Balance	\$10,577	\$11,035	\$12,181	\$13,792	\$12,889
Percent Liability Coverage	105.7%	110.6%	105.7%	102.7%	95.4%
Employee Benefits Balance	4,273	5,180	\$6,853	\$6,424	\$7,056
Recommended Fund Balance	1,812	1,981	\$5,474	\$5,125	\$5,056
Percent Liability Coverage	235.8%	261.5%	125.2%	125.3%	139.6%

Source: City of Scottsdale, Financial Services Department.

In the fiscal year-ended June 30, 2001, the City began recording the self-insured benefits in the self-insurance fund. FY 2003/04 include claim projections for the fire personnel effective FY 2005/06 and beyond.

Calculation: Self Insurance Fund Balance/Recommended Actuarial Fund Balance (*100)

CONDITION OF CAPITAL PLANT

Condition of Capital Plant

The bulk of the City's wealth is invested in its physical assets or capital plant – 75 percent of its streets, buildings, utility network, and equipment. If these assets are not maintained in good condition, or if they are allowed to become obsolete, the result is often a decrease in the usefulness of the assets, an increase in the cost of maintaining and replacing them, and a decrease in the attractiveness of the City as a place to live or do business.

Cities often defer maintenance and replacement because it is a relatively painless short-run method to reduce expenditures and ease current financial strain. Continued maintenance deferral, however, can create serious long-term problems that become exaggerated because of the large sums of money invested in capital facilities.

The following are some of the problems associated with continued deferred maintenance:

- Creation of safety hazards and other liability exposures.
- Reduction in the residential and business value of the City.
- Decreased efficiency of equipment due to obsolescence and deferred maintenance.
- Increased costs of bringing the facility up to acceptable levels after continued maintenance deferral.
- Creation of a large unfunded liability in the form of a backlog in maintenance that can result in accelerated deterioration.

The indicators detailed on the following pages can be used to monitor changes in the condition of capital plant.

CONDITION OF CAPITAL PLANT

Maintenance Effort

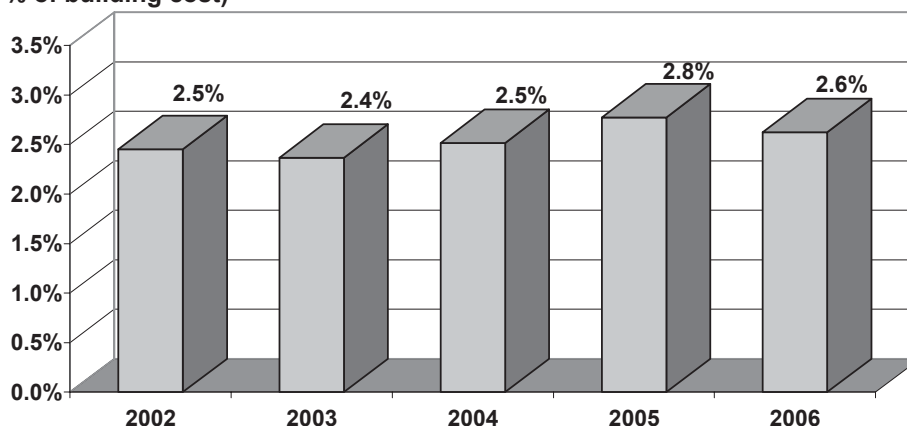
Description

The condition of the City's long-lived assets, such as buildings, is significant because of the tremendous cost and far-reaching consequences their decline can have on business activity, property values, and operating expenditures. Deferral of maintenance on the assets and their subsequent deterioration can create a significant unfunded liability. Maintenance expenditures should remain relatively constant in relation to the cost and nature of assets maintained. If the ratio is declining, it may be a sign that the City's assets are deteriorating.

Analysis

Maintenance expenditures as a percent of building and improvement costs have remained consistent over the measured period. This trend is favorable as it indicates that the City's buildings and improvements are being maintained in good working condition and that the maintenance expenditures on a per unit basis are not increasing due to deterioration of the assets.

(as % of building cost)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Maintenance Expenditures	\$6,489	\$6,579	\$6,563	\$7,509	\$7,767
Building & Improvements Costs	\$264,387	\$277,841	\$260,709	\$270,572	\$295,730
Percent Maintenance Expenditures/Building Costs	2.5%	2.4%	2.5%	2.8%	2.6%

Sources: FYE 2002-2006 Capital Asset Note-Governmental Activities - Buildings and Land Improvements.

Calculation: Maintenance Expenditures/Building and Improvement Costs (*100)

CONDITION OF CAPITAL PLANT

Capital Outlay

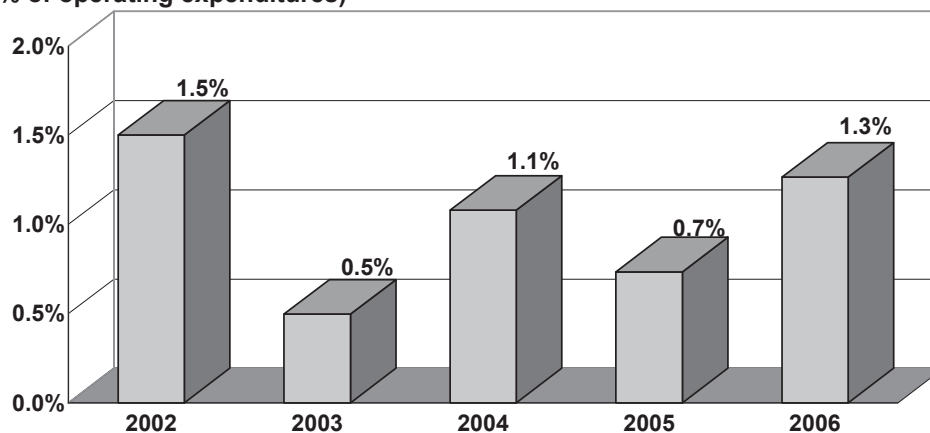
Description

The expenditure for operating equipment, such as vehicles, radios, and computer and office equipment purchased from the operating budget is referred to as capital outlay. It includes equipment that will last longer than one year and costs more than \$5,000. Capital expenditures may remain constant or even decline in the short run as new and replacement equipment is purchased. If the decline persists over three years, it can be an indicator that capital outlay needs are being deferred, resulting in the use of obsolete equipment and the creation of an unfunded liability.

Analysis

Capital outlay expenditures as a percent of net operating expenditures have remained relatively neutral over the five-year measured period. The 1.0 percent decrease in fiscal year 2003 can be attributed to prudent budgeting and spending practices during tight economic times and declining revenue streams; the subsequent decrease in 2005 is due to increased public safety tax approved by voters and the related increase in service expenditures. Considering the adjustments to capital outlay spending, the trend indicates that operating equipment is being maintained in good condition, thus avoiding the use of obsolete and inefficient equipment and the creation of an unfunded liability.

(as % of operating expenditures)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Capital Outlay	\$3,770	\$1,294	\$2,797	\$2,072	\$3,767
Operating Expenditures	\$251,142	\$259,960	\$259,378	\$282,269	\$298,049
Percent Capital Outlay/Net Operating Expenditures	1.5%	0.5%	1.1%	0.7%	1.3%

Sources: FYE 2002-2006 Special Revenue and General Fund "Capital Improvement" Expenditures - Statement of Revenue and Expenditures.

Calculation: Capital Outlay/Operating Expenditures (*100)

CONDITION OF CAPITAL PLANT

Depreciation

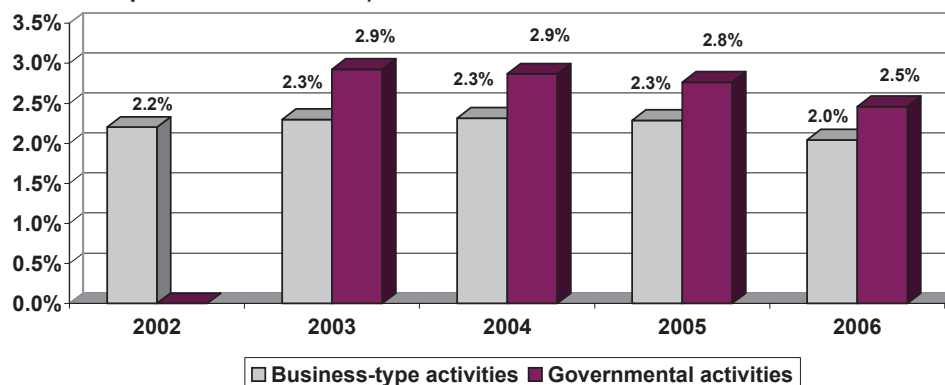
Description

Depreciation is the mechanism by which cost is associated with the use of a fixed asset over its useful life. Depreciation should remain a relatively stable portion of asset cost assuming older assets, which are fully depreciated, are removed from service and replaced with newer assets. If depreciation costs start to decline as a portion of asset cost, the assets are probably being used beyond their useful lives, the estimated useful lives had been initially underestimated, or the scale of operations was reduced.

Analysis

Depreciation expense has remained a stable portion of fixed asset costs, which indicates that assets are being fully depreciated and replaced with newer assets on a timely basis. This will prevent a large expense, in any one year, to replace outdated assets. In addition, for the fiscal year ended June 30, 2002, the City was required to adopt Governmental Accounting Standards Board Statement No. 34 which required the depreciation of all governmental assets. For fiscal years 2003-2006 the depreciation expense related to governmental assets remained consistent in relation to the City's enterprise assets.

(depreciation expense as % of assets)



(in thousands)	FYE 6/02	FYE 6/03	FYE 6/04	FYE 6/05	FYE 6/06
Business-type Activities					
Depreciation Expense	\$20,003	\$21,542	\$23,756	\$26,143	\$26,490
Fixed Asset Costs	\$907,875	\$936,661	\$1,026,018	\$1,142,211	\$1,295,289
Percent Depreciation Expense/ Fixed Asset Costs	2.2%	2.3%	2.3%	2.3%	2.0%
Governmental Activities					
Depreciation Expense	\$82,278	\$83,363	\$85,861	\$89,209	\$92,511
Fixed Asset Costs	\$2,721,662	\$2,848,435	\$2,992,224	\$3,225,118	\$3,760,809
Percent Depreciation Expense/ Fixed Asset Costs	-	2.9%	2.9%	2.8%	2.5%

Source: FYE 2002-2006 CAFR Notes to Financial Statements - Capital Asset section.

Note: With the implementation of Governmental Accounting Standard Board Statement No. 34 at June 30, 2002, the City is required to depreciate all governmental assets.

Calculation: Depreciation Expense/Fixed Asset Costs (*100)